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Decision No. 59485

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 and sell $72,000,000 principal amount of Thirty-three Year ____% Debentures due February 1, 1993, (b) to execute and deliver an Indenture to be dated February 1, 1960, and (c) to offer 10,045,630 common shares for subscription and sale for cash at $14-2/7 per share to the holders of its common and preferred shares.

Application No. 41706

Arthur T. George, for applicant; Edward L. Blincoe, in propria persona and for Utility User's League, intervenors; Dion R. Holm, City Attorney, Thomas M. O'Connor, Utility Counsel and Robert R. Laughead, Chief Valuation and Rate Engineer, by Robert R. Laughead, for the City and County of San Francisco, interested party; Donald E. Hall, for Washington Public Service Commission, interested party; Sidney J. Webb for the Commission's staff.

O P I N I O N

In this application the Commission is asked to make its order authorizing The Pacific Telephone and Telegraph Company (1) to issue and sell $72,000,000 principal amount of debentures, (2) to execute and deliver an indenture and (3) to issue and sell 10,045,630 shares of its common stock of the aggregate par value of $143,509,000.

The application was filed on November 30, 1959. After due notice, a public hearing was held before Examiner Donovan in San Francisco on December 21, 1959, at which time the matter was taken under submission.

Sale of Securities

Applicant has come before the Commission on numerous occasions, in applications similar in form to the one now under review, for authorization to issue and sell debentures and common stock to finance the cost of property. At this time, it once again seeks to employ the same methods it has used in the past in disposing of its securities and it proposes, upon receiving the necessary regulatory approval, to put up its debentures for sale at competitive bidding and to offer the common shares to the holders of its presently outstanding shares of preferred and common stock, pursuant to the provisions of its Articles of Incorporation, which confer upon the holders of its presently outstanding shares of stock, both preferred and common, the pre-emptive right to subscribe to any new issues of common shares.

Accordingly, applicant proposes to offer the 10,045,630 shares of common stock at par to the holders of its outstanding preferred and common shares in the proportion of one new common share for each ten common shares and seven new common shares for each ten preferred shares standing in the name of each shareholder of record on its stock books at the close of business on a date to be fixed by the board of directors. 1/

1/ According to Exhibit 1, the American Telephone and Telegraph Company presently owns 90.21% of applicant's outstanding shares of stock.

The company proposes to invite bids for the purchase of the $72,000,000 of debentures, the winning bid to determine the interest rate. The debentures are to be issued under a new indenture to be dated February 1, 1960, between applicant and The Bank of California, National Association, as trustee. They will be dated February 1, 1960, will mature February 1, 1993 and will be redeemable at the option of the corporation on any date prior to maturity upon not less than 30 nor more than 90 days' notice, to and including January 31, 1961, at a price six points above the public offering price and thereafter at annually reducing premiums.

It is estimated that the sale of the debentures will be completed in February, 1960 and the sale of the common shares in March, 1960.

Use of Proceeds

Applicant proposes to use the proceeds to be received from the issue of its debentures and stock for the purpose of reimbursing its treasury, to the extent such proceeds are sufficient, for moneys actually expended since October 31, 1922, from income or other treasury funds of applicant and its subsidiary for the acquisition of property and for the construction, completion, extension and improvement of facilities. Applicant reports that as of September 30, 1959, such unreimbursed expenditures amounted to $748,103,021.34 and that approximately 70 per cent of such amount had been paid or provided for with money represented by depreciation reserves, approximately 20 per cent by retained earnings and the balance primarily by current accounts.

Applicant, at this time, does not seek full reimbursement. It asserts that it has need for the cash to be derived through the issue of the securities covered by this application in order to repay outstanding temporary loans from American Telephone and Telegraph Company, to provide for extensions, additions and improvements to its telephone and telegraph plant and to provide funds for similar requirements of its subsidiary, Bell Telephone Company of Nevada, and for other corporate purposes. It estimates that in the absence of permanent financing, its short-term borrowings from its parent company will amount to $140,000,000 as of February 24, 1960, and to $207,000,000 as of March 31, 1960. Following the sale and issue of the common shares and debentures and the receipt of the proceeds therefrom, it is anticipated that its short-term borrowings will be paid in full.

Capital Structure

According to the record, the company has endeavored, by alternating debt and stock financing, to maintain a capital structure with a debt ratio at a level considered by it as prudent, in view of its continuing large amount of construction. Applicant reports that in 1956 it sold $234,154,000 of stock and debentures, in 1957, $272,169,000, in 1958, $239,407,000 and it estimates that it will obtain $215,509,000 from the issuance of the securities for which authority is now being requested. Its capital ratios are as follows:

	September 30, 1959	Pro Forma December 31, 1959	Pro Forma December 31, 1960
Debt	36.8%	38.3%	36.8%
Preferred stock	3.2	3.2	2.9
Common stock and surplus	60.0	58.5	60.3
Total	100.0%	100.0%	100.0%

It appears that upon conclusion of the financing presently proposed that applicant will again build up its debt ratio by borrowings as it proceeds with its 1960 construction program.

Protest

An intervenor, appearing in his own behalf as a ratepayer and for Utility User's League, took exception to the issue, by applicant, of common stock alleging that the company's proposal will result in increased cost to the ratepayer. He requested (1) that an examiner's report be issued so that exceptions could be taken prior to the issuance of a final decision by the Commission; (2) that none of the common stock requested to be issued by applicant be authorized at any price or for any purpose; (3) that none of the proceeds from the issue of the debentures be allowed to apply to the unreimbursed expenditures of $748,103.021.34 shown in Exhibit E attached to the application; and (4) that the Commission, before authorizing the issue of debentures, ascertain that the proceeds to be derived from the issue of said debentures would be applied to proper betterments and improvements and not to the refunding of short-term borrowings.

Conclusions

The Commission, in numerous financing proceedings involving this as well as other applicants, has considered the possible effect on the ratepayers which might result from the raising of money through the issue of equity rather than debt capital and while recognizing the fact that, in some proceedings such as the one now before it, management desires to maintain a debt ratio which is somewhat lower than that maintained by the average utility, it is of the opinion that it should not interfere with the judgment of management in this regard unless and until it can be demonstrated that the proposed form of financing will result in an undue burden on the ratepayer. In the proceeding now before us, applicant, by Exhibit 8, introduced evidence to show that the substitution of $143,509,000 of common stock for 4-1/2% short-term notes would have the effect of lowering its rate of return .14% and that such reduction is due to an increase in state and federal taxes on income resulting from the loss of an interest deduction. Applicant further introduced testimony to the effect that the .14% variation in rate of return was less than it encounters in the regular month-to-month variation in its income.

The company has been before the Commission on numerous occasions during the past 14 years for authorization to issue securities and to increase rates and the Commission is familiar with its construction program and with the demands for service with which it is faced. From a review of the information before us, it clearly is apparent that applicant has made expenditures for plant well in excess of the proposed security issues for which it has not been reimbursed with funds from permanent capitalization. It is equally apparent that applicant will have need for the proceeds which it will receive from the two proposed offerings to liquidate its outstanding short-term indebtedness, to improve its cash position and to enable it to proceed with the expansion of its plant and facilities. With the volume of construction facing applicant, it is obvious that a large part of its requirements must be met with equity funds in order that it might establish and preserve an elastic capital structure which will enable it to obtain additional capital in the future under favorable terms.

Upon a full consideration of the record, we are of the opinion that intervenors' requests should be denied and that the application should be granted. In making our order herein we again place applicant on notice that the authorization herein is for the issuance of securities only and that we will not regard the dividends paid on its shares of stock as determining or fixing the rate of return it should be allowed to earn on its investment in plant and that the approval herein given is not to be construed as indicative of amounts to be included in a future rate base for the purpose of determining just and reasonable rates.

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 July 31, 1960, may offer not to exceed 10,045,630 shares of its common stock for subscription and sale, for cash, at not less than $14-2/7 per share, to the holders of its outstanding shares of preferred and common stock in the proportion of one new common share for each ten common shares and seven new common shares for each ten preferred shares standing in the name of each shareholder of record on its stock books at the close of business on a date to be fixed hereafter. Upon receipt by applicant of subscriptions properly executed and the necessary funds, applicant may thereafter issue certificates for the appropriate number of shares.

2. The Pacific Telephone and Telegraph Company, after the effective date hereof and on or before July 31, 1960, may execute and deliver an indenture to be dated February 1, 1960, in substantially the same form as that filed in this proceeding as Exhibit C, and may issue and sell $72,000,000 principal amount of Thirty-three Year Debentures due February 1, 1993, at a price which will result in the lowest annual cost of money to applicant.

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. Immediately upon awarding the contract for the sale of said $72,000,000 of debentures, The Pacific Telephone and Telegraph Company shall file a written report with the Commission showing, as to each bid received, the name of the bidder, the amount of the bid, the interest rate and cost of money to applicant based upon such price and interest rate, and the name of the bidder to whom the contract for the sale of the debentures was awarded.

5. Within 30 days after the issue and sale of the debentures under the authorization herein granted, The Pacific Telephone and Telegraph Company shall file a report with the Commission showing the date on which such debentures were sold and the consideration received, and within 30 days after the

closing date of subscriptions for the shares of stock herein authorized to be issued, applicant shall file with the Commission a report showing the number of shares of stock subscribed for by American Telephone and Telegraph Company, the number of shares of stock subscribed for by others, the consideration received, and the purposes for which the proceeds were expended.

6. As soon as available, The Pacific Telephone and Telegraph Company shall file with the Commission three copies of its prospectus.

7. The authority herein granted to execute an indenture and to issue and sell debentures will become effective when applicant has paid the fee prescribed by Section 1904(b) of the Public Utilities Code, which fee is $21,000. In other respects, the authorization herein granted will become effective 20 days after the date hereof.

8. The request of intervenors for an examiner's report is denied.

Dated at San Francisco, California, this 12th day of January, 1960.

PUBLIC UTILITIES COMMISSION
STATE OF CALIFORNIA
PAID
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BY

President

Commissioners