Decision No. 68892

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 $125,000,000 principal amount of Thirty-Five Year % Debentures due May 1, 2000, (b) to execute and deliver an Indenture to be dated May 1, 1965, and (c) to offer 10,045,176 common shares for subscription and sale for cash at $20 per share to the holders of its common and preferred shares.	Application No. 47362 Filed February 26, 1965

Arthur T. George, for applicant;
Charles W. Sullivan, for City of Los Angeles, interested party;
Joseph D. Patello, for City of San Diego, interested party;
Thomas M. O'Connor, City Attorney, by Orville I. Wright, Deputy City Attorney, and Robert R. Laughead, Chief Valuation and Rate Engineer, for City and County of San Francisco, interested party;
Edward L. Blincoe, in propria persona and for Utility User's League of California, interested parties; and
Sidney J. Webb, for the Commission staff.

O P I N I O N

This is an application for an order of the Commission authorizing The Pacific Telephone and Telegraph Company to execute and deliver an indenture, and to issue and sell $125,000,000 principal amount of debentures and 10,045,176 shares of common stock.

After due notice, a public hearing in this matter was held before Examiner Donovan in San Francisco, on March 18 and 23, 1965, and on the latter date the matter was taken under submission.

The company proposes to invite bids for the purchase of the $125,000,000 of debentures, the winning bid to determine the interest rate. The debentures are to be issued under a new indenture to be dated May 1, 1965 between applicant and The Bank of California, National Association, as trustee. They will mature May 1, 2000 and will not be redeemable prior to May 1, 1970, on which date the initial redemption price will be four points above the public offering price. For subsequent years the redemption price will be at annually reducing premiums, provided that on and after May 1, 1995, said price will be 100 percent of the principal amount. Accrued interest to the date fixed for redemption will be added in each instance.

Subject to receiving the required regulatory authorization, applicant proposes to offer 10,045,176 shares of its common stock at $20 per share to shareholders of record on May 27, 1965, in the ratio of one common share for each eleven common shares outstanding and seven common shares for each eleven preferred shares outstanding. Exhibit No. 1 shows that applicant's presently outstanding stock consists of 820,000 shares of $100 par value preferred stock and 104,756,943 shares of $14-2/7 par value common stock, of which 640,957 shares (78.17%) and 94,542,139 shares (90.25%), respectively, are owned by American Telephone and Telegraph Company.

Applicant proposes to use the estimated $325,900,000 of proceeds to be received from issuing said debentures and common 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 and other treasury funds of applicant for the acquisition of property and for the construction, completion, extension and improvement of plant facilities of The Pacific Telephone and Telegraph Company and its subsidiary, Bell Telephone Company of Nevada. Applicant reports that as of December 31, 1964, such unreimbursed expenditures amounted to $915,534,030.33. Exhibit No. 2, which relates to construction expenditures, shows estimated 1965 gross additions amounting to $445,350,000 and $14,400,000 for The Pacific Telephone and Telegraph Company and Bell Telephone Company of Nevada, respectively.

Applicant expects that all of the treasury funds to be derived from the financing proposed in this proceeding will be used to repay temporary borrowings from American Telephone and Telegraph Company. Said temporary borrowings were utilized by applicant to carry out its construction program, and it is estimated that said borrowings will amount to $337,000,000 by June 30, 1965, in the absence of permanent financing. The excess, if any, of funds to be provided by the proposed financing will be used for construction and other proper corporate purposes.

Appearances on behalf of the Cities of Los Angeles and San Diego, the City and County of San Francisco and the Utility User's League of California, together with Edward L. Blincoe individually, subjected applicant's witness to extensive cross-examination directed primarily to the price at which applicant proposes to issue and sell its shares of common stock, and to its proposal to issue and sell both shares of common stock and debentures, instead of only debentures, so as to finance its requirements in accordance with an objective of maintaining a debt ratio in the neighborhood of 35 per cent. However, none of the appearances protested the granting of the application.

For many years applicant has followed the practice of offering to its shareholders, pursuant to their pre-emptive rights, additional shares of its common stock at their par value even though both the book value and market value of the common shares were in excess of par. The proposed offering of common stock in this proceeding at a price in excess of par value is a departure from its prior practice. The company attributes such departure to the substantial increase during recent years in the book value of its common stock resulting from the sale of its northwest properties. Said book value amounted to approximately $18 per share as of December 31, 1964, and the market price was around $30 per share at the time of the hearing.

It is applicant's position that it is desirable for the minority shareholders to continue their participation in the company and that an offering in excess of the $20 price per share might discourage such continued participation. Applicant also points out that the amount of paid-in capital would be the same if the 10,045,176 shares were to be sold at $20 or a lesser number at a higher price than $20 per share. Its vice-president and comptroller testified that the sale of stock at a price less than the market does not affect the rate of return which the company is entitled to receive on its investment in operative property and hence does not affect the rates which customers would be asked to pay for service.

Applicant stated that it has been endeavoring, by the use of both debt and stock financing, to maintain a capital structure with a debt ratio considered by it to be prudent in view of its continuing large amount of construction. The company reports that it sold stock and debentures aggregating $234,154,000 in 1956, $272,169,300 in 1957, $239,406,500 in 1958, $215,437,844 in 1960, and that it sold $100,000,000 of debentures but no stock in 1964. Inasmuch as applicant had available approximately $682,000,000 from the sale of its northwest properties, it did not deem it necessary to sell any securities during the years 1961, 1962 or 1963, and sold only debentures in 1964.

In order to obtain funds to finance, in part, the 1965 construction program of applicant and its subsidiary, The Pacific Telephone and Telegraph Company proposes to sell stock and debentures contemplated to produce proceeds approximating $325,900,000. Applicant anticipates that financing in the immediate future will be at approximately the same dollar volume per annum, although it does not contemplate any permanent financing during 1966. Applicant's reported capitalization ratios, with advances from American Telephone and Telegraph Company included in debt, at December 31, 1964, and estimated at June 30, 1965 and December 31, 1965, giving effect to the financing proposed in this proceeding, are as follows:

	Actual	Pro Forma	
	Dec. 31, 1964	June 30, 1965	Dec. 31, 1965
Debt	37.8%	34.1%	35.5%
Preferred stock	2.6	2.5	2.4
Common stock and surplus	59.6	63.4	62.1
Total	100.0%	100.0%	100.0%

The Commission, in numerous financing proceedings involving this applicant 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 securities rather than debt. While recognizing the fact that, in some proceedings such as the one now before us, management desires to maintain a debt ratio which is somewhat lower than that maintained by other utilities, the Commission is of the opinion that it should not in this proceeding interfere with the judgment of management. In the proceeding now before us applicant presented evidence showing that: (a) total debt financing in place of the combination of equity and debt financing now contemplated would cause its debt ratio to increase to approximately 41 percent by the end of 1965; (b) its capital obligations would increase by approximately 10 percent through the proposed issue of securities with anticipated proceeds amounting to around $325,900,000; and (c) under these circumstances and knowing that future capital requirements would be of like magnitude, applicant would be remiss in its duties were it not to conserve its borrowing capacity so as to maintain itself in a position enabling it to finance when necessary under varying, including unfavorable, conditions.

From a review of the information before us it is clear that applicant, both now and in the future, will be required to raise large sums of new capital to finance its construction program, and that its proposed method of financing the 1965 construction program is part of a long range program which anticipates that a large part of the capital requirements must be met with equity funds in order that a flexible capital structure be maintained which will make possible the obtaining of additional capital funds in the future at a reasonable cost.

Upon consideration of the record in this proceeding the Commission finds that:

1. Applicant will be required in the future to raise substantial sums of money each year to finance its construction program.

2. This is a proceeding involving the issuance of securities and not the fixing of rates.

3. Definitive evidence that the proposed form of financing will result in an undue burden on the ratepayer is absent.

4. When fixing rates the Commission can and does give such consideration as it deems necessary to the methods employed by applicant in financing its construction program.

5. In view of the prevailing circumstances as developed in this proceeding, the Commission should not interfere with the decision of applicant's management as to the type of securities to be issued.

6. The proposed debenture and common stock issues are for proper purposes.

7. Applicant will have need for funds from external sources for the purposes set forth in this proceeding.

8. The inclusion of a five-year restricted redemption provision in the terms of the debentures will enable applicant to obtain funds at a lower annual cost than it otherwise could.

9. The money, property or labor to be procured or paid for by the issue of the debentures and common stock herein authorized is reasonably required for the purposes specified herein, and such purposes, except as otherwise authorized for accrued interest, are not, in whole or in part, reasonably chargeable to operating expenses or to income.

On the basis of the foregoing findings we conclude that the application should be granted. In issuing our order herein, we place applicant and its shareholders on notice that we do not regard the number of shares outstanding, the total par value of the shares nor the dividends paid as measuring the return applicant should be allowed to earn on its investment in plant and that the authorization herein given is not to be construed as a finding of the value of applicant's stock or properties nor as indicative of amounts to be included in proceedings for the determination of just and reasonable rates.

O R D E R

IT IS ORDERED that:

1. The Pacific Telephone and Telegraph Company, on or after the effective date hereof and on or before November 1, 1965, may execute and deliver an indenture to be dated May 1, 1965, in the same form, or in substantially the same form, as that filed in this proceeding as Exhibit C, and may issue and sell not to exceed $125,000,000 aggregate principal amount of its Thirty-Five Year Debentures due May 1, 2000, at competitive bidding to the purchaser, or purchasers, offering to it the most favorable terms as disclosed by the bids received.

2. The Pacific Telephone and Telegraph Company, on or after the effective date hereof and on or before November 1, 1965, may offer not to exceed 10,045,176 shares of its common stock, for subscription and sale for cash at $20 per share, to the holders of its common and preferred shares in the proportion of one common share for each eleven common shares and seven common shares for each eleven preferred shares standing in the name of each shareholder of record on the stock books of applicant at the close of business on May 27, 1965, and, upon receipt by applicant of properly executed subscriptions and necessary funds, may issue certificates for the appropriate number of shares.

3. The Pacific Telephone and Telegraph Company shall use the proceeds from the sale of said stock and debentures, other than accrued interest, to reimburse, so far as possible, its treasury for funds expended by applicant as set forth in the application. The accrued interest to be received may be used for said purpose or for general corporate purposes.

4. Immediately upon awarding the contract for the sale of said 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 price, the interest rate and the cost of money to applicant based upon such price and interest rate, together with the name of the bidder to whom the contract for the sale of the debentures was awarded.

5. Within thirty days after the closing date of subscriptions for the shares of stock herein authorized to be issued, The Pacific Telephone and Telegraph Company 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, and the consideration received. Such statement shall be filed in lieu of a report, or reports, under General Order No. 24-B.

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

7. This order, insofar as it pertains to debentures and the related indenture, shall become effective when The Pacific Telephone and Telegraph Company has paid the fee prescribed by Section 1904(b) of the Public Utilities Code, which fee is $34,250. In all other respects this order shall become effective ten days after the date hereof.

Dated at San Francisco, California, this 13th day of APRIL, 1965.

Frederick B. Holoboff
President

Commissioners

PUBLIC UTILITIES COMMISSION
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