

ORIGINAL

Decision No. 74389

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 \$165,000,000 )  
principal amount of Thirty-Five )  
Year % Debentures due )  
July 1, 2003, (b) to execute )  
and deliver an Indenture to be )  
dated July 1, 1968, and (c) to )  
do equity financing in the )  
amount of approximately )  
\$165,000,000 by the offering of )  
common shares for subscription )  
and sale for cash to the holders )  
of its common and preferred )  
shares. )  
\_\_\_\_\_ )

Application No. 50105  
Filed March 22, 1968  
and Amendments  
Filed April 18, 1968

Arthur T. George, for applicant;  
Thomas C. Lynch, Attorney General, by Donald B. Day, Deputy  
Attorney General, for State of California, interested party;  
William C. Taylor, Deputy City Attorney, and Robert R. Lauchhead,  
Rate Engineer, for City and County of San Francisco, interested  
party;  
Ralph Hubbard and W. L. Knecht, for California Farm Bureau  
Federation, interested party;  
Dennis T. Pezcocke, for California Labor Federation, interested  
party;  
Hector Anninos and Leonard L. Snaider, for the Commission staff.

O P I N I O N

In this application, as amended, The Pacific Telephone and Telegraph Company seeks an order of the Commission authorizing it (a) to execute and deliver an indenture, (b) to issue and sell \$165,000,000 principal amount of debentures by means of a public offering through competitive bidding, and (c) to offer not exceeding 8,763,728 additional common shares for subscription and sale for cash to the holders of its common and preferred shares to realize approximately \$165,000,000 in proceeds, subject to a later determination by this Commission, on the filing of a supplemental application by applicant, of the precise number of shares of stock to be offered, the price at which the shares are to be offered, and other terms and conditions of the offer.

After due notice, a public hearing in this matter was held in San Francisco on April 17 and 19, 1968, before Commissioner Gatov and Examiner Donovan with Commissioner Bennett in attendance on the first day and Commissioner Symons in attendance on both days. Although some opposition to the issuance of common stock at this time was voiced by staff and interested parties, no party appeared as a protestant in the proceeding. At the close of the hearing the matter was taken under submission subject to filing of an exhibit prepared by the Commission's Finance and Accounts Division and of briefs, all of which have been received.

The successful bid will determine the interest rate of the new debentures to be sold through competitive bidding. Such debentures will be issued under a new indenture to be dated July 1, 1968. They will bear a maturity date of July 1, 2003, and will not be redeemable prior to July 1, 1973, on which date the initial redemption price will be four and one-half points above the public offering price. For subsequent years the redemption price will be at annually reducing premiums, provided that on and after July 1, 1998, said price will be 100% of the principal amount. Accrued interest to the date fixed for redemption will be added in each instance.

Applicant proposes to obtain approximately \$165,000,000 through offering not exceeding 8,763,728 shares of its \$14-2/7 par value common stock to shareholders of record on its stock books at the close of business on August 23, 1968. On July 26, 1968, the company plans to file a supplemental application setting forth the exact number of shares to be offered, the price at which it intends to offer them, and other terms and conditions of the offer. Exhibit No. 5 shows that applicant's presently outstanding stock consists of 820,000 shares of preferred stock and 125,715,921 shares of common stock, of which 640,957 shares (78.17%) and 113,365,803 shares (90.18%), respectively, are owned by American Telephone and Telegraph Company.

The record in this proceeding shows that the proceeds (estimated at \$330,000,000) to be derived by the utility from selling said debentures and common stock will be applied toward reimbursing its treasury for moneys actually expended from income and from other treasury funds of applicant and its subsidiary, Bell Telephone Company of Nevada, for the acquisition of property and for the construction, completion, extension and improvement of facilities of the two corporations. Applicant reports that as of February 29, 1963, such unreimbursed expenditures amounted to \$1,256,244,361. Exhibit No. 1, which relates to construction expenditures, shows estimated 1968 gross additions amounting to \$459,449,000 and \$8,000,000 for The Pacific Telephone and Telegraph Company and Bell Telephone Company of Nevada, respectively.

Applicant anticipates using all of the treasury funds to be derived from the financing proposed in this proceeding for repaying temporary borrowings from American Telephone and Telegraph Company. The record shows that said temporary borrowings were, and will be, utilized by applicant to carry out its construction program. It is estimated that said borrowings would approximate \$354,000,000 by the end of September, 1968, 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.

It appears that the proposed financing will result in a slight increase in the debt ratio of applicant as compared with that prevailing after the last offering of the company's common shares. The debt ratio, with due regard to anticipated short-term borrowings, is estimated to average 38.8% for the year 1968 and 38.9% for the year 1969, assuming the issuance of the proposed securities. Although applicant had been endeavoring to maintain an average debt ratio in the neighborhood of 35%, it is now, with apparent reluctance, moving toward an objective of a 40% range. The company alleges that such objective is substantially achieved through the proposed financing and that, in any event, a larger debenture issue would be undesirable particularly in view of existing market conditions. Exhibit No. 6 shows that the proposed financing consisting of approximately one-half debt and one-half equity represents an increase in the proportion of debt financing as compared with approximately one-third debt generally prevailing in the previous decade.

The brief of the Commission's Legal Division urges the Commission not to authorize the common stock portion of the proposed financing. Its conclusion is based upon (a) the absence of details to be supplied by a supplemental application pertaining to the proposed common stock offering, and (b) the possible effect on rate making of the company's relatively low debt ratio.

A statement of the Attorney General of the State of California explains his participation as follows:

"The Attorney General is participating in this proceeding as an interested party because the issues brought before the Commission by the applicant here have an important bearing upon certain key issues of Application No. 49142, in which the Attorney General also is a party."

Mr. Dennis T. Peacocke, Research Associate, California Labor Federation, AFL-CIO, in addition to relating this financing proceeding to said Application No. 49142, is critical of an aspect of the internal functioning of this Commission as follows:

"It is also apparent that the application already has been substantively approved by the Hearing Examiner (Tr. 130). In this regard it is clear that in the future such applications should be heard by an examiner not called upon to pass judgment on his own handiwork."

Commission staff counsel, through extensive cross-examination of applicant's witness and by brief filed in this proceeding, raised questions regarding (1) the relationship of applicant with its parent, American Telephone and Telegraph Company, (2) the decision of applicant to maintain a ratio of debt to total capitalization in the range of 40%, and (3) the impact that the proposed financing might have on applicant's rates. It appears appropriate to set forth our observations on these as well as similar issues raised by other parties.

It is of record in this proceeding that American Telephone and Telegraph Company owns approximately 90% of applicant's outstanding capital stock. By reason of such stock ownership American Telephone and Telegraph Company is in a position to direct the policies of applicant. For purposes of this proceeding, however, it is immaterial whether American Telephone and Telegraph Company's or applicant's management establishes the policies followed by applicant or dictated the language of the application. In this proceeding we have before us a request of applicant to issue securities and it will be granted or denied on the basis of the record.

A long standing policy of applicant has been to maintain a debt ratio substantially below those of other large utilities operating in California subject to the jurisdiction of this Commission. The policy has been mentioned with disfavor by this Commission in a number of prior decisions.

By employing a hypothetical debt ratio, as it has done on occasion in fixing rates of other utilities, the Commission could counteract any impact the proposed financing might have on applicant's rates. For examples, in West Coast Telephone Company of California, 60 CPUC 759, 765 (1963) and Citizens Utilities Company of California, 61 CPUC 37, 42 (1963) the Commission employed hypothetical ratios.

At this point, it is well to mention some excerpts from Exhibit No. 8, a memorandum of applicant to American Telephone and Telegraph Company on strategy and timing:

"While we would thus attain the objective range of 40% somewhat faster than the Bell System as a whole, we believe we could do this without embarrassment to the System and with considerable advantage in our present posture before the PUC."

"Public announcement of the Company's financing plans in March and the filing of a financing application with the Commission shortly thereafter may be expected to have a favorable effect on the rate order itself. It should impress the Commission with the need for prompt action in the rate case to carry through the scheduled financing."

"Some of the present Commissioners feel strongly that our debt ratio should be considerably higher than it is today, but we believe that this plan to gradually increase our debt ratio over the next two or three years will impress them favorably."

"However, the announcement and the filing of a petition which mentions equal amounts of debt and equity will have definite advantages in our relations with the Commission."

This application might easily be denied in its entirety on the premise it is largely a stratagem contrived to have an effect on applicant's rate case (Application No. 49142).

It is clear that applicant's short-term loan arrangement with American Telephone and Telegraph Company can be extended reasonably without serious consequences, in which case even the precise timing indicated essential by applicant does not appear to be critical.



What we have here in substance is a minor change in applicant's heretofore intransigent position on debt ratio. If indeed we were favorably impressed by this gesture, it eludes us as to how it is all translatable into the possibility we would thereafter (a) be prompted to accelerate deliberation in a rate case, (b) get impressions generally resulting in actions favorable to the applicant in the subject case, and (c) agree with the company's view that it would "have definite advantages in our relations with the Commission." This need not prevent us from reaching a decision on applicant's need for a more permanent form of financing, as opposed to continued short-term borrowings from American Telephone and Telegraph Company of sums exceeding several hundred millions of dollars.

The financing proposed by applicant will not affect its rates, which may be fixed only in a rate proceeding such as that pending before this Commission in Application No. 49142. In rate proceedings this Commission does give careful consideration to the capital structure maintained by applicants. Because of the low leverage position desired by this applicant, however, the rate of return found reasonable obviously provides for earnings on equity capital at a lower rate than if applicant were to maintain a higher debt ratio. The end result of maintaining a low debt ratio is, of course, to reduce the return per common stock share.

Applicant's desire to maintain a conservative capital structure will not, however, result in higher rates to its subscribers than would occur with a higher and, we feel, a more realistic debt ratio.

The advisability if not the propriety of permitting the Director of the Commission's Finance and Accounts Division to function also as the presiding examiner in this proceeding was questioned. This long standing procedure has never been shown to be unfair, or unreasonable, and has never been heretofore suspect of being detrimental to the public or to applicants. It enables the Commission to make highly technical decisions economically, efficiently and with dispatch. We are not disposed to change this procedure on the basis of the record in this proceeding. In any event, the Commission, and not a particular examiner, must pass judgment on all aspects of the proceeding. Furthermore, in this particular instance, said examiner presided jointly with a commissioner, and most of the time one or two other commissioners were in attendance at the hearing.

With respect to the incomplete record pertaining to the common stock offering, Section 819 of the Public Utilities Code authorizes the Commission to grant permission to issue securities subject to such conditions as it deems reasonable and necessary. By way of comparison the unknown items of price and interest rate pertaining to the proposed debentures are not questioned. The

final details relating to the common stock offering must be acceptable to the Commission, or the company may not consummate the transaction.

After consideration the Commission finds that:

1. The Pacific Telephone and Telegraph Company, applicant herein, is a California corporation operating as a public utility subject to the jurisdiction of this Commission.
2. Applicant's reported unreimbursed capital expenditures as of February 29, 1968, amounted to \$1,256,244,361.
3. Applicant seeks authority to issue and sell securities on or before December 1, 1968, which will produce approximately \$330,000,000 of proceeds for reimbursing its treasury.
4. Applicant's unreimbursed capital expenditures far exceed \$330,000,000.
5. The proposed debenture and common stock issues are for proper purposes.
6. Applicant has need for funds from external sources for the purposes set forth in this proceeding.
7. The only witness in this proceeding was Mr. John Einerman, Vice-President and Comptroller of applicant.
8. All evidence in this proceeding is unrefuted.
9. The proposed indenture provides for a five-year restricted redemption provision with respect to the proposed \$165,000,000 principal amount of debentures.
10. Applicant seeks authority to issue and sell securities on or before December 1, 1968, which will produce approximately \$330,000,000 of proceeds for reimbursing its treasury.
11. Applicant's reported unreimbursed capital expenditures far exceed \$330,000,000.
12. The proposed debenture and common stock issues are for proper purposes.
13. Applicant has need for funds from external sources for the purposes set forth in this proceeding.
14. All evidence in this proceeding is unrefuted.
15. The proposed indenture provides for a five-year restricted redemption provision with respect to the proposed \$165,000,000 principal amount of debentures.

10. Applicant will be required to pay interest at a lower effective rate than it would in the absence of the proposed restricted redemption provision.
11. The proposed indenture will not be adverse to the public interest.
12. The debenture and indenture portions of this proceeding are not subjects of dispute.
13. 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.
14. During the past decade it has been applicant's general policy to offer securities in proportions of 1/3 debentures and 2/3 common stock.
15. Recently, applicant changed its policy of seeking to maintain a 35% debt ratio by changing such objective to 40%.
16. The present proposal to offer 50% debentures and 50% common stock would increase insignificantly applicant's proportion of debt as compared with equity.
17. This proceeding differs from many similar proceedings instituted by applicant in the past principally by proposing to increase the proportion of debentures by issuing approximately half debentures and half common stock, and by postponing the determination of the offering price and other terms and conditions of the common stock offering.

18. The Commission has recently closed the record on a statewide rate proceeding (A.49142) pertaining to applicant.
19. No evidence in this proceeding is a part of the record in said rate proceeding.
20. The principal issue in this proceeding pertains to the relatively low debt ratio of applicant.
21. The payment of additional interest instead of dividends as a result of issuing debentures in lieu of common stock would reduce the burden of taxes based on income.
22. In fixing just and reasonable rates this Commission can and has disregarded actual debt-equity ratios and established hypothetical ratios.
23. In view of applicant's relatively low debt ratio, holders of shares of its common stock must be prepared to receive a diminished return on their equity.
24. The theoretical effect on rates arising from the issue of additional securities is immaterial in this proceeding.
25. The relationship between debt and equity is a subject for managerial judgment in the absence of an impairment of financial stability or an abuse of discretion.
26. The proposal to issue additional equity securities will not adversely affect applicant's financial stability.
27. The record in this proceeding is devoid of any evidence of abuse of managerial discretion.
28. In accordance with Section 819 of the Public Utilities Code the Commission may grant permission to issue stock subject to such conditions as it deems reasonable and necessary.

29. On July 26, 1968 applicant proposes to file in this proceeding a supplemental application setting forth the precise number of shares of common stock to be offered, the price at which the shares are to be offered, and other terms and conditions of the offer.
30. The record contains no opposition to a public hearing on the proposed supplemental application pertaining to the common stock offering.
31. Applicant is controlled through stock ownership by American Telephone and Telegraph Company.
32. As of December 31, 1967, applicant had 2,506 and 57,276 reported preferred and common shareholders, respectively, in addition to American Telephone and Telegraph Company.
33. Applicant's financial stability should continue to remain on a sound footing irrespective of its affiliation with American Telephone and Telegraph Company.
34. Insofar as this proceeding is concerned, it is immaterial whether or not applicant's financing policies are established by American Telephone and Telegraph Company.
35. Although the Director of the Commission's Finance and Accounts Division presided jointly with a Commissioner at the hearing in this proceeding, only members of the Commission, itself, can decide the matter.
36. No party is adversely affected by the fact that the Director of the Commission's Finance and Accounts Division acted as an examiner in this proceeding.

On the basis of the foregoing findings we conclude

that:

1. The application, as amended, should be granted as specified in the ensuing order.

2. On July 31, 1968, a hearing should be held on the proposed supplemental application pertaining to the common stock offering.

In issuing our order herein, we place applicant and its stockholders 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 granted 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 may execute and deliver an indenture in the same form, or in substantially the same form, as that attached to the application as Exhibit C.

2. The Pacific Telephone and Telegraph Company may invite the submission of written sealed bids for the purchase of not exceeding \$165,000,000 aggregate principal amount of its Thirty-Five Year Debentures due July 1, 2003.

3. The Pacific Telephone and Telegraph Company may issue and sell said debentures in the aggregate principal amount of not exceeding \$165,000,000 at the price offered in said bids which will result in the lowest cost of money to applicant calculated in the manner provided in the Statement of Terms and Conditions Relating to Bids attached to the application as a part of Exhibit D.

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

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 herein authorized to be issued and sold.



7. Within thirty days after the issue and sale of the debentures herein authorized, The Pacific Telephone and Telegraph Company shall file with the Commission a statement, in lieu of a report under General Order No. 24-B, disclosing the purposes for which the debenture proceeds were used.

8. Subject to the filing of a supplemental application by applicant and a subsequent determination by this Commission by supplemental order thereon, all pertaining to the precise number of shares of stock to be offered, the price at which the shares are to be offered, and other terms and conditions of the offer, The Pacific Telephone and Telegraph Company may offer not exceeding 8,763,728 additional common shares for subscription and sale for cash to the holders of its common and preferred shares to realize approximately \$165,000,000 in proceeds.

9. The Pacific Telephone and Telegraph Company shall use the proceeds to be derived from the issuance and sale of said stock to reimburse, so far as possible, its treasury for funds expended as set forth in the application.

10. A public hearing is hereby set for said supplemental application before Commissioner Gatov and Examiner Donovan for Wednesday, July 31, 1968, at 10:00 a.m., in the Commission Courtroom, State Building, San Francisco, California, at which time and place all interested parties may appear and be heard.

11. Transmittal by the Commission's Secretary of a copy of this decision to each appearance of record in this proceeding shall fulfill the official notification requirement pertaining to the public hearing herein set for Wednesday, July 31, 1968.

12. Ordering Paragraph No. 8 hereof shall become effective when the Commission, by supplemental order, has made the determination referred to therein. In all other respects this order 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 \$44,250. Any authority herein granted will expire if not exercised on or before December 1, 1968.

Dated at San Francisco, California,  
this 9th day of JULY, 1968.

*I concur in  
the Order:  
Peter E. Kishell*

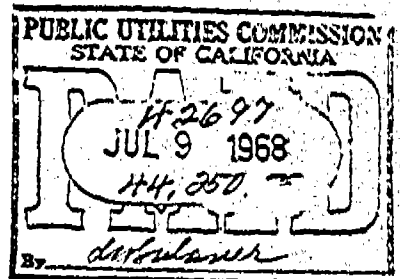
*William S. ...  
President*

\_\_\_\_\_

*Angela ...*

\_\_\_\_\_  
Commissioners

*I will file a dissent on specific  
aspect of this order  
Fred P. Moroney.*



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WILLIAM BENNETT, COMMISSIONER, DISSENTING

I dissent. From the standpoint of due process and fairness let alone meaningful participation by the Commission staff, the approval of this decision represents a disregard for basic concepts of a fair hearing. Applicant here worked out the details of this application with the Director of Finance and Accounts and obtained his approval of the proposed financing in advance of the hearing. Thereafter the Director acted as examiner in this proceeding, heard the testimony, and thereafter wrote today's opinion and order signed by the majority. This is self-judgment at its worst. The Director of Finance and examiner finds no fault with the process whereby he prejudices an application, gives his approval to the utility applicant and then sits in judgment upon the hearing and thereafter writes the decision. Self-judgment is usually kindly and this case is no exception. As a lawyer familiar with the concepts of due process and a fair hearing I cannot concur in today's order on that basis alone.

A most important defect exists in the present record. The public protection and the advice and testimony which might otherwise have come to the Commission was denied it because the Director of Finance (the examiner) elected not to make any showing with the expertise in his division either critical or in approval of the application. The staff counsel herein was allocated by any staff showing simply because the Division of Finance and Accounts defaulted upon its responsibility.

This decision before the promulgation of the rate order is premature. It goes against the objective of this Commission that the capital ratios of Pacific Telephone and Telegraph Company be improved. This decision will in fact aggravate a condition the Commission has in the past criticized. There is nothing in this record and there might have been by way of a showing which would permit more issuance of debt security than Pacific requested. And I am not impressed with arguments that this amount of debt capital

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could not be raised in today's market. There are timetables and there are debt financing applications which can be placed in bits and pieces rather than in one whole.

It is quite obvious from the excerpts in Exhibit 8 that Pacific deliberately sought by this financing application to affect the applicant's rate case. Indeed the majority opinion so holds and also finds that this financing at this time is not necessary. Consistent, however, with the non sequitur of the majority as to the qualifications of the Director of Finance the Commission then goes on to approve the debt financing.

The strangest part of the order, however, lies in the commitment the majority has made to the equity financing by Pacific. The Commission goes out of its way to encourage a supplemental application, which incidentally avoids an additional filing fee.

But the language is quite clear that the Commission is committing itself not to further financing by debt capital but by common equity. All the Commission wants to know is the precise number of shares and the price thereof. These are the issues--nothing is said about whether or not further debt financing should be compelled and nothing is said about the impact of the additional common upon earnings per share. It is myth even in view of rate of return techniques to suppose that the dilution of existing common equity will not have an effect and an impact upon earnings per share and lend credence to the chant of Pacific ever heard that its earnings per share are dangerously low. Pacific is contributing to that condition today with Commission approval. I would reopen these proceedings to inquire further into the real meaning of Exhibit 8 and to inquire further into whether or not Pacific is in fact free to affect and to construct its own capital structure. I want to know whether Pacific is merely reacting to directives from American Telephone and Telegraph Company which I strongly suspect is the case. The record herein discloses that Commissioner Bennett requested the presence of Jerome Hull, President of Pacific Telephone


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and Telegraph Company, for examination and for testimony by him concerning the complete financing arrangements contained in the application. Despite the fact that request was made to Commissioner Gatov by Commissioner Bennett for special day in which to examine Mr. Hull and despite the fact that there was an understanding about such arrangement the matter was submitted and Mr. Hull was excused from giving testimony. It is a strange practice and one prompting wonder and concern when one commissioner's request is arbitrarily denied by another member of this Commission.

If the public interest is to be met by this Commission and the staff thereof, it should promptly discontinue the highly suspect, indeed improper, practice whereby Commission personnel are assigned to sit in judgment upon cases after having made prejudgments thereon. Of course, the climate of regulation today with public utility influence widespread if not dominant in a sense makes irrelevant improprieties which may or may not benefit utilities upon the part of staff members.

The Commission is presently operating under the curious notion that the mere power of mortal vote usually 4 - 1 in some unknown manner repeals provisions of the California Constitution, the Public Utilities Act and the basic requirements of due process. I disagree, of course, and again would set this matter down for further hearing to determine whether or not debt financing should be increased and I would deny that portion of the application which sought and got an advisory opinion in advance.

/s/ WILLIAM M. BENNETT

  
William M. Bennett  
Commissioner

Dated: San Francisco, California  
July 9, 1968

COMMISSIONER FRED P. MORRISSEY DISSENTING

I dissent from the majority opinion and order because I disagree with the policy and procedure which the Commission applied in this case. Specifically my objections are aimed at (1) the inadequate record and hasty procedure for review of a major utility's proposed financing, (2) the undue emphasis placed on immaterial evidence, and (3) the unfounded charge of foul play within the Commission.

With regard to the portion of the order dealing with capital structure and the issuance of new securities, some observations are in order. While the majority decision approves the trend toward a higher debt ratio, the Commission's hasty involvement in capital structure determination, without an adequate investigation into all the facts, leaves much to be desired.

This Commission has on a number of occasions expressed its displeasure with applicant's capital structure, specifically the low proportion of debt capital that applicant has utilized. I, too, share the Commission's belief that applicant can increase its debt ratio without prejudice to its financial strength. As stated in the opinion, the Company is moving to a higher debt ratio, specifically 40%, with the present financing establishing about a 39% ratio. Thus the Company is taking a step in the right direction, in my view.

It appears to be the policy of this Commission to review a utility's capital structure and proposed financing when an application for new financing approval is sought. We look at the proposed security issues in the light of interest rates, cost of capital, fixed charge coverage, conventional or accepted capital structure ratios, etc. These procedures would appear adequate when the utility is maintaining a conventional financing policy and where no appreciable change is occurring in capital structure, financing instruments, or the capital

market. At present, however, the capital market is extremely volatile, even unstable, with substantial fluctuations in interest cost from month to month, albeit with a strong upward tendency. The enormous demands for capital by California utilities, in excess of a billion dollars last year, and expectations for similar amounts in 1968 and 1969, further complicate the uncertainties and difficulties to be encountered.

As a regulatory body working within this economic community, we should neither blindly accept any proposal put forth by the utility nor unduly delay a financing application through irresponsible actions and untimely inquiries. Instead, the most serious study and attention should be given to the Commission procedures for analyzing and approving utility financing proposals.

Our policy of reviewing a utility's financing has two shortcomings, in my view. First of all, the procedure is too closely related to the immediacies of issuing additional securities, and, secondly, it lacks adequate attention to a long-term (two to five years) financial plan of the utility.

As mentioned before, the majority has seen fit to interject itself into the capital structure determination of the applicant in this case. To embark upon such a task without a full investigation into various financial plans for the future is lacking in foresight. In the present sophisticated corporate world, capital investment needs and methods of financing must be projected for several years. Management must prepare alternate financing plans for the future just as they prepare capital construction budgets. Thus before this Commission can seriously involve itself with capital structure determination, we should have before us alternate plans or proposals for future financing. To use the utility's request for immediate financing as a platform for enunciating policy statements with regard to capital structure is untimely and dangerous. It is untimely because the capital market is already informed

of the proposed financing, its magnitude and timing, and any delays or doubts caused by Commission action will increase financing costs to the utility. And it is dangerous because any substantial changes required by the Commission may well be proposed without adequate information on financing needs in the future. For corporations requiring repeated recourse to the capital market, the type of security issued currently may well determine the type of security that must be issued in the next round of financing. Hence any Commission modifications of financing proposals attendant upon applications for approval of new security issues are likely to be misdirected. This Commission should remove itself from these ad hoc decisions and consider security issue approval in the light of long-term financial plans previously reviewed by the Commission.

Exhibit No. 8 in my view is entirely irrelevant to the application and resultant decision. What was in an executive's mind leading up to the filing of the application is entirely without significance for this Commission. Exhibit No. 8 is an internal memorandum of the Company, apparently detailing an executive's reasoning on the financing proposal. Why we should be interested in what motivates a utility to file an application is beyond me -- rather the application itself and the testimony and evidence offered are what we should base our decision upon. There is no one on the Commission qualified to act as a psychiatrist and to interpret alleged motivations, and we should not try. Accordingly Exhibit No. 8 should have been disregarded entirely in the decision and order.

Finally, the criticism of the Director of Finance and Accounts, Mr. Donovan, and his relationship in this case is unnecessary. Mr. Donovan has served frequently as the Hearing Examiner in financing applications such as this one. In fact, this dual function has been the long-established practice not only for Mr. Donovan but also his predecessors, Mr. Freyman Coleman and Mr. W. C. Fankhauser. Furthermore,

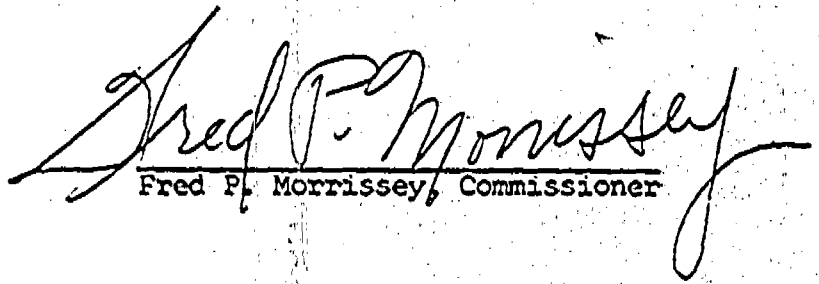


it is clear to all parties that any decision emanating from this Commission is the product of the Commission. We sign the orders and must accept responsibility for their content. Hence it is meaningless to suggest that the application ". . . has been substantively approved by the Hearing Examiner . . . ." because only the Commission can make the ultimate decision.

It is even more astonishing to find Commissioner Bennett alleging claims of ". . . disregard for basic concepts of a fair hearing. . . ." in his dissent to this decision when he is fully aware that it has been the standard practice of this Commission to have the Director of Finance and Accounts serve as Examiner in financing applications -- in fact, it has been done repeatedly in the ten years while Commissioner Bennett served as Commissioner, President, and Chief Counsel to this Commission. He is also aware of our policy of assigning cases to a Commissioner and an Examiner. The proposed assignments are submitted to the full Commission and approved during its regular weekly meeting. Accordingly each Commissioner is fully aware of the Commissioner and Examiner who will be responsible for an application or proposed investigation before a hearing date is set. Commissioner Bennett could have easily voiced his objection at the time the assignment list was circulated or at the Commission conference. Now, however, he would have the public believe that "due process" is suddenly being denied because of "utility influence" and improper pressures upon staff members. One must wonder what suddenly motivates his abhorrence of this practice after he has approved it for so many years, including its use in a number of previous financing cases of the present applicant.

In the light of this background any allegation of foul play arising from the Hearing Examiner's "prior approval" of the application is both improper and misguided. If there is something incorrect or improper in the long-established practice of having the head of Finance and Accounts sit as Examiner, the Commission can easily correct it

without countenancing a challenge to the integrity of a dedicated  
public servant.

  
Fred P. Morrissey, Commissioner

San Francisco, California

July 16, 1968