CACD/BVC

Decision 89-10-024 October 12, 1989 ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of CONTEL OF CALIFORNIA, INC. (U 1003 C), a corporation, for an order authorizing it to issue and sell up to $40,000,000 of long-term indebtedness and for exemption from competitive bidding.	Application 89-07-039 (Filed July 19, 1989)

OPINION

Summary of Decision

This decision grants Contel of California, Inc. (Contel) the authority requested in the application. Contel requests authority under Public Utilities (PU) Code Sections 816 through 830 and 851, for the following:

1. To issue and sell a new series of Contel's First Mortgage Bonds in the aggregate principal amount of $40,000,000;
2. To execute and deliver a further supplemental indenture to its first Mortgage Indenture, dated as of February 1, 1954;
3. To sell the proposed issue by negotiated private placement;
4. Exemption from the Competitive Bidding Rule for the proposed issue; and
5. To use the net proceeds (exclusive of accrued interest) for the purposes set forth in the application.

Notice of the filing of the application appeared on the Commission's Daily Calendar of July 27, 1989. No protests have been received.

Contel, a California corporation, and the wholly owned subsidiary of Contel Corporation, a Delaware corporation, owns and operates telephone systems in various portions of California, Nevada and Arizona, providing exchange telephone service for its local customers and exchange access service to interexchange carriers. Contel is a public utility subject to the jurisdiction of this Commission.

For the six months ended June 30, 1989, Contel reported total operating revenues of $164,519,000 and net income of $33,741,000 as indicated in its Income Statement shown as part of Exhibit B attached to the application.

Also shown as part of Exhibit B is Contel's balance Sheet as of June 30, 1989, summarized as follows:

Assets	Amount
Net Utility Plant	$478,553,000
Other Assets	8,308,000
Current Assets	57,294,000
Deferred Charges	1,284,000
Total	$545,439,000

Liabilities and Equity	
Common Equity	$227,875,000
Preferred Stock	2,330,000
Long-Term Debt	109,772,000
Capital Lease	437,000
Current Liabilities	132,170,000
Deferred Credits	72,855,000
Total	$545,439,000

Proposed Financing

Contel proposes to issue $40,000,000 aggregate principal amount of a new series of its First Mortgage Bonds (Debt Securities), in part to provide funds to refund certain classes of Contel's outstanding securities which, by their terms, mature during 1989 and 1990. Through normal maturities and sinking fund requirements for long-term debt, Contel will retire approximately $24,000,000.

In addition to the normal sinking fund and maturities requirements, Contel will use the balance of the proceeds from the issue to finance in part its planned construction program for 1989.

Contel states that it believes that by increasing its percentage of long-term debt it will benefit its customers by lowering its overall cost of capital. This proposed financing will move Contel's capital structure closer to the percentages specified in Decision (D.) 89-05-059. Contel further believes that current long-term debt market conditions offer a "window" of relatively favorable interest rates that will further benefit the company and its ratepayers.

The portion of the proceeds of the Debt Securities which are received in advance of the date of retirement of any particular series of long-term debt would be applied, pending such retirement, to the reimbursement of Contel's treasury for construction expenditures not previously funded through external financing.

Subject to receiving an exemption from the Competitive Bidding Rule requested in the application; Contel, with the assistance of its investment bankers, Drexel Burnham Lambert Incorporated, negotiated the sale of the Debt Securities by private placement with a single major institutional purchaser, The Prudential Insurance Company of America (Prudential). The proposed Debt Securities will be designated "First Mortgage bonds, Series W, (9.41%) due 2014," will bear interest at 9.41% per annum, will mature on October 1, 2014, and will be entitled to a sinking fund in later years which will produce an average life of the Debt Securities of approximately 18.4 years. The Debt Securities will be non-callable for 10 years and callable thereafter at gradually reducing premiums. The purchase price will be 100% of the aggregate principal amount thereof, plus accrued interest, if any, to the date of closing. For its assistance in the transaction, Contel has agreed to pay its investment bankers a fee of .375% (37.5 basis points or $150,000) of the principal amount of the Debt Securities.

The Debt Securities would be issued in accordance with, secured by, and have terms and conditions as set forth in the indenture dated February 1, 1954, executed and delivered by Contel to Bank of America National Trust and Savings Association and Successor individual trustee, as Trustees, as amended to date by twenty-four supplemental indentures, and the proposed supplemental indenture. The proposed supplemental indenture is substantially similar to the form of the Twenty-Fourth

Supplemental Indenture filed with the Commission in connection with Application (A.) 86-07-060 (filed July 29, 1986), except for those changes necessary to reflect the designation and series, aggregate principal amount, interest rate, maturity and sinking fund requirements for the proposed Debt Securities.

The purchase agreement to be used in connection with the sale of the Debt Securities will be substantially similar to the form of purchase agreement used in connection with Contel's Series Q Bonds (also purchased by Prudential), except for changes similar to those required in the supplemental indenture providing for the Debt Securities.

Request for Exemption from the Commission's Competitive Bidding Rule

Contel states that the Debt Securities are entitled to an exemption from the competitive bidding rule under Paragraph (3) of the Order contained in Resolution No. F-616 (dated October 1, 1986). A sale of the entire issue of the Debt Securities to one major institutional investor cannot be accomplished through a competitive bidding process. The Staff Report attached to Resolution No. F-616 recognized this fact (see page 5, lines 16-17). The application states that, by dealing with a single purchaser, Contel is able to negotiate terms which are tailored to the needs of the purchaser, while at the same time producing terms (both as to interest rate and maturity) which it believes to be more favorable to Contel than those available through a public offering and sale; based on Contel's extensive review of current market conditions, it is convinced that the interest rate on the Debt Securities is 10 basis points lower than available in the public market; by selling to one institutional purchaser, Contel avoids the printing, legal, accounting, and SEC registration fee expenses, and other miscellaneous costs, and the delay of a public sale; the private placement fee of 37.5 basis points is less than the spread which might be expected with a public sale; and Contel alleges that it is not a well-known company outside of California, nor well known in the competitive bid market (its last public sale having occurred in 1973), and believes that the proposed $40,000,000 of Debt Securities is not of sufficient size to attract the interest of a large number of major bidders to form adequate investment syndicates.

Contel states that the sale of the Debt Securities in the manner proposed will produce the lowest effective interest cost, for the benefit of both Contel and its ratepayers, and that the exemption from competitive bidding is in the public interest. CACD notes and we concur that this decision does not find these costs or the proposed costs of this debt issue to be reasonable for ratemaking purposes. Reasonable cost of capital for ratemaking purposes is established in a general rate or attrition proceeding.

Use of Proceeds

Contel proposes to use the proceeds of the Debt Securities, other than accrued interest and after payment of expenses of insurance, for one or more of the following purposes:

(a) For the acquisition of property;

(b) For the construction, completion, extension or improvement of its facilities;

(c) For the improvement or maintenance of its services;

(d) For the lawful refunding of its obligations; and

(e) For the reimbursement of its treasury for money actually expended from income or from other money in its treasury not secured by or obtained from the issue of stocks, stock certificates or other evidences of interest or ownership, or bonds, notes or other evidences of indebtedness for the foregoing purposes. In addition, a portion of such proceeds may be used to repay short-term indebtedness incurred for the foregoing purposes.

As of June 30, 1989, Contel's construction expenditures unreimbursed from the sale of securities amounted to $263,283,000.

Capital Ratios

Contel's capital ratios as of June 30, 1989 are shown below as recorded and as adjusted to give pro forma effect to the proposed financing:

	June 30, 1989	Pro Forma	Authorized D.89-05-059
Common Equity	65.51%	62.63%	53.00
Preferred Stock	.74	.70	3.00
Long-Term Debt	33.75	36.67	44.00
Total	100.00%	100.00%	100.00%

The pro forma capital ratios, as set forth above, assume the retirement of $24,000,000 of outstanding long-term debt and do not include any future adjustments to retained earnings.

Construction Budgets

Contel's gross construction budgets for calendar years 1989 and 1990 amount to about $150,157,000, estimated as of June 30, 1989, summarized as follows:

Item	1989	(000's)	1990
Land	$ 761		$ 483
Vehicle/Aircraft	2,162		1,731
Building	4,170		4,223
COE-Digital	23,061		24,023
COE-All Other	6,312		6,917
Outside Plant	25,384		27,126
All Other Plant	11,307		13,497
	$73,157		$78,000

The CACD has made note of Contel's construction budgets and finds that the financing would be necessary to fund the proposed construction and to partially reimburse Contel's treasury for capital additions and improvements. The CACD has no objection to Contel's proposed issuance and sale of the Debt Securities as requested in the application; however, Contel is placed on notice, by this decision, that the Commission does not find that Contel's construction program is necessary or reasonable for ratemaking purposes. These are issues normally tested in general rate case or rate base offset proceedings.

Cash Requirements Forecasts

Contel's cash requirements, for the years 1989 and 1990 estimated as of June 30, 1989 and shown as part of supplemental data furnished to the CACD, are shown as follows:

	1989	(000's)	1990
Funds used and/or Required for Construction Expenditures	$74,157		$74,371
Sinking Fund Payments	6,460		17,634
Total	$80,617		$92,005
Less: Cash from Internal Sources	25,062		36,218
Additional Funds Required From Outside Sources	$55,555		$55,787

The CACD notes that for Contel's cash requirements forecasts for 1989 and 1990 internally generally funds will provide about 34% or $25,062,000 of capital requirements in 1989 and about 49% or $36,218,000 in 1990. Contel will require additional funds from outside sources amounting to about $55,555,000 in 1989 and $55,787,000 in 1990. CACD concludes that Contel's proposed issuance and sale of the Debt Securities is necessary to help meet forecasted cash requirements.

Findings of Fact

1. Contel, a California corporation, operates as a public utility under the jurisdiction of this Commission.

2. Contel has need for external funds for the purposes set forth in the application.

3. The proposed issuance and sale of the Debt Securities are for proper purposes and not adverse to the public interest.

4. The money, property, or labor to be procured, or paid for, by the proposed Debt Securities is reasonably required for the purposes specified in the application, and such purposes are not, in whole or in part, reasonably chargeable to operating expenses or to income.

5. To exempt Contel from the Commission's Competitive Bidding Rule as requested in the application is in the public interest.

6. The Commission does not, by this decision, determine that Contel's cost of debt is necessary or reasonable for ratemaking purposes. These issues are normally tested in general rate case or rate base offset proceedings.

7. The Commission does not, by this decision, determine that Contel's construction budget is necessary or reasonable for ratemaking purposes. These issues are normally tested in general rate case or rate base offset proceedings.

8. There is no known opposition to this proceeding and no reason to delay granting the authority requested.

Conclusions of Law

1. A public hearing is not necessary.

2. The application should be granted to the extent set forth in the order that follows.

3. The proposed Debt Securities are for lawful purposes and the money, property, or labor to be obtained by them is required for these purposes. Proceeds from the security issues may not be charged to operating expenses or to income.

4. The following order should be effective on the date of signature, to enable Contel to proceed with its financing expeditiously.

The fee due or payable under PU Code Section 1904(b) is $14,000, after taking into account the credits for retirements described in the application.

O R D E R

IT IS ORDERED that:

1. Contel, on or after the effective date of this order and on or before December 31, 1990, is authorized to issue, sell and deliver for cash up to $40,000,000 aggregate principal amount of Debt Securities, by negotiated private placement, on terms and conditions substantially consistent with those described in or contemplated by the application and such additional terms and conditions to be negotiated by Contel customary for an issue such as the Debt Securities.

2. Contel is authorized to execute and deliver a supplemental indenture in substantially the same form as its Twenty-Fourth Supplemental Indenture filed in connection with A.86-07-060, with such changes therein as are required to reflect the terms and conditions negotiated for the Debt Securities.

3. Contel shall file with the CACD, within 15 days of the date of the decision, three copies of the supplemental indenture.

4. The Debt Securities are exempted from the Commission's competitive bidding rule as set forth in Resolution No. F-616.

5. Contel shall file the reports required by General Order No. 24.

6. Contel shall apply the proceeds from the Debt Securities to the purposes set forth in the application.

7. The application is granted as set forth above.

The authority granted by this order to issue the Debt Securities will be effective when Contel pays $14,000, the fee determined under Public Utilities Code Section 1904(b). In all other respects, the order is effective today.

Dated OCT 12 1989, at San Francisco, California.

G. MITCHELL WILK
President
FREDERICK R. DUDA
STANLEY W. HULETT
JOHN B. OHANIAN
PATRICIA M. ECKERT
Commissioners

PUBLIC UTILITIES COMMISSION
STATE OF CALIFORNIA
PAID
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By

I CERTTIFY THAT THIS DECISION WAS APPROVED BY THE ABOVE COMMISSIONERS TODAY.

Wesley Franklin

WESLEY FRANKLIN, Acting Executive Director

CACD/BVC

Decision 89 10 024 OCT 1 2 1989

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