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Decision 82 07 095 JUL 21 1982

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the matter of the application of Southern Pacific Communications Company for authority to issue notes and other evidences of indebtedness in the aggregate principal amount of $76,140,000 and to exempt such notes from competitive bidding.	Application 82-05-61 (Filed May 25, 1982)

O P I N I O N

Southern Pacific Communications Company (SPCC) seeks authority to issue notes and other evidences of indebtedness in the aggregate principal amount of $76,140,000, and an exemption from the Commission's competitive bidding rule.

Authority is requested under Public Utilities (PU) Code Sections 816 through 830. Notice of the filing of the application was published on the Commission's Daily Calendar of May 27, 1982. No protests have been received.

SPCC is a Delaware corporation and is a wholly owned subsidiary of Southern Pacific Company. SPCC is a specialized common carrier of telecommunications currently operating between San Francisco and Los Angeles on the West Coast and such cities as Boston, New York, and Washington, D.C. on the East Coast. In addition to holding licenses and construction permits issued by the Federal Communications Commission, SPCC possesses a certificate of public convenience and necessity granted by Commission Decision (D.) 84167, dated March 4, 1975 (as affirmed by our D.89580, dated October 31, 1978), in Application (A.) 55284. The certificate authorizes SPCC, as a public utility to establish intercity private line communication service for voice and data transmission between the Cities of Bakersfield, Fresno, Los Angeles, Merced, San Francisco, and Stockton.

The income statement for the year 1981, attached to the application as Exhibit F, indicates that SPCC generated operating revenue of $230,882,000, operating income of $34,317,000, and net income of $21,888,000. The company's Balance Sheet as of December 31, 1981, is summarized as follows.

Assets	Amount
Current Assets	$ 65,413,000
Property, Plant and Equipment	279,665,000
Other Assets and Deferred Charges	6,867,000
Total	$351,945,000
Liabilities and Common Equity	
Current Liabilities	$ 63,110,000
Notes Payable	178,266,000
Other Liabilities	62,033,000
Common Equity	48,536,000
Total	$351,945,000

SPCC proposes to enter into loan agreements, financing transactions, and issue up to $76,140,000 of notes and other evidences of indebtedness to Nissho Iwai American Corporation (Nissho). The debt securities will be used to purchase 12 new high capacity switching systems which will route incoming and outgoing calls and record billing information, upgrade SPCC's existing network, support its forecasted growth objectives and provide for future expansion. Nissho will design, engineer, furnish, install, and maintain during a warranty period, the switching systems. The financing will consist of the following:

Description	Amount
First Promissory Note	$14,555,455
Second Promissory Note	15,497,337
Third Promissory Note	46,087,208
Total	$76,140,000

The proposed first and second notes will be repaid in 10 equal semiannual installments commencing in March 1986, with interest at .75% per annum above the London Interbank Offering Rate (LIBOR) for six-month deposits. On May 25, 1982 LIBOR was 14-3/8%. The proposed loan agreement and promissory notes will be unconditionally guaranteed by Southern Pacific Company, as to principal and interest.

Between the proposed effective date of the loan agreement and March 1986, when the first of the 10 semiannual repayment installments is due, interest shall be compounded semiannually and added to the principal balance of the loan on the first repayment date.

The third note will be financed through the Japanese Export/Import Bank. It will bear interest at the rate of 8-1/2% compounded quarterly. It will be repaid in 10 equal semiannual installments.

The notes to be issued and the deferred payments to be made will be the general obligations of SPCC and will not be secured by a mortgage or other lien on any operating properties or other assets of SPCC. Copies of the proposed loan agreement, promissory notes, and purchase agreement are attached to the application as Exhibits B, C, and D.

SPCC requests an exemption from the Commission's competitive bidding requirements with respect to the proposed issuance of notes. The application sets forth the following reasons as justification for an exemption.

> "Since the date of its incorporation in Delaware on January 23, 1970, the Applicant has been continuously occupied in obtaining its required licenses and permits from the FCC and other

governmental agencies, in constructing its communications system, and in marketing its services. Applicant commenced interstate common carrier communications service on December 26, 1973. Since that time, it has experienced severe rate competition from American Telephone and Telegraph Company (and its operating subsidiaries) which has resulted in Applicant operating at a net loss in each year through 1980. Despite AT&T's rate competition, Applicant generated a positive cash flow and earned an operating profit of $34.3 million for the year 1981. However, at the present time, Applicant does not have a history of earnings necessary to commend securities to the investing public and to meet rating standards acceptable to Applicant. However, due to confidence in the Applicant and its proposed operations, Nissho is prepared to loan necessary funds upon the terms stated in the application which are believed by the Applicant to be more advantageous than any loan financing which could be obtained by Applicant through competitive bidding.

"Greater flexibility is obtained by placing this financing privately with Nissho rather than making a public distribution of securities. Unexpected developments may occur in any new enterprise and it is of value to have its securities closely held to permit necessary changes to be negotiated in the event such developments become significant. Private placements of securities, including privately negotiated loans, have been widely adopted for the financing of new companies. Furthermore, Nissho has considerable knowledge of Applicant's proposed communications system and business operations by reason of its involvement in the construction of the Applicant's Southeast microwave radio system.

> "It is the considered judgment of Applicant that under present market conditions, loans on as favorable terms as the proposed financing cannot be obtained through the public offering of Applicant's securities, or by competitive bidding. $46,087,208 of the proposed financing is at the highly favorable interest rate of 8 1/2%. The remaining cost of the switching systems is financed at .75% over the London Interbank Offering Rate which is 14-3/8% for six-month deposits on May 25, 1982. Applicant considers this financing to be exremely favorable."

In D.91984, dated July 2, 1980 for the San Diego Gas & Electric Company, A.59633, we discussed the granting of exemptions from the competitive bidding rule, and we clarified the nature of the compelling showing that must be made to warrant an exemption from the rule. We served notice that assertions regarding the volatility of the market, the flexibility provided by a negotiated sale, and the importance of maximizing the effectiveness of an underwriting group will not serve as compelling reasons individually or collectively, for granting an exemption from the competitive bidding rule.

Because the proposed debt securities will be placed privately to known parties, on terms which are reasonable under the circumstances, we are of the opinion that applying, in this proceeding, the Commission's competitive bidding requirements and conditions set forth in D.91984, is not necessary. We will, however, also grant SPCC the optional authority to issue the proposed debt securities by means of a competitive offering.

SPCC is put on notice that in the event of a general rate proceeding before the Commission, the reasonableness of the resulting interest rate and cost of money to the company will be closely scrutinized and may result in a disallowance of interest expense if it is determined that the cost of money incurred was not the most prudent. We will also require SPCC to provide the Commission with a showing that the interest rate on the proposed notes and the resulting cost of money were the most advantageous to the company and its ratepayers. We will require this showing within a reasonable period after the issuance and sale of the proposed securities.

SPCC requests the Commission find that the California Usury Law does not apply to the proposed issuance and sale of notes or to the proposed loan agreements. The Commission in exercising its authority to regulate public utility debt securities is not restricted by the California Usury Law (Article XV, Section 1, of the California Constitution).

The Revenue Requirements and the Communications Divisions have reviewed the application and have concluded that the proposed financing is necessary to implement the company's construction program. The Divisions reserve the right, however, to reconsider the reasonableness of any specific construction expenditure in future rate proceedings.

Findings of Fact

1. SPCC is a Delaware corporation subject to the jurisdiction of this Commission in that it is authorized and qualified to do business in the State of California.

2. The proposed notes are for proper purposes.

3. SPCC has need for external funds for the purposes set forth in this proceeding.

4. The rates of interest applicable to the proposed notes are favorable to SPCC under current market conditions.

5. The proposed notes should not be required to be issued through competitive bidding.

6. The money, property, or labor to be procured or paid for by the proposed notes is reasonably required for the purposes specified in the application. Proceeds from the security issue may not be charged to operating expenses or to income.

Conclusions of Law

1. Under plenary powers granted to the Legislature by Article XII, Section 5, of the California Constitution, the Legislature is authorized to confer additional consistent powers upon the Public Utilities Commission as it deems necessary and appropriate, unrestricted by any other provisions of the California Constitution.

2. The Legislature has conferred upon the Public Utilities Commission the authority to regulate the issuance of public utility securities, including evidence of indebtedness, and to prescribe restrictions and conditions as it deems reasonable and necessary (PU Code Sections 816 et seq.).

3. Under the plenary powers granted to the Legislature in Article XII, Section 5, of the California Constitution, it conferred on the Public Utilities Commission the comprehensive and exclusive power over the issuance of public utility securities, including evidences of indebtedness; and the California Usury Law cannot be applied as a restriction on the Public Utilities Commission's regulation of such issuances of public utility securities, including its authorization of a reasonable rate of interest.

4. If the usury limitation contained in Article XV of the California Constitution and the Usury Law Initiative Act is exceeded, but the transaction is authorized by this Commission and the terms are the best SPCC can obtain because of market conditions, SPCC, its assignees or successors in interest, will have no occasion to and cannot assert any claim or defense under the California Usury Law; further, because of lawful issuance by SPCC of notes in compliance with authorization by the Public Utilities Commission, persons collecting interest on such authorized notes are not subject to the Usury Law's sanctions.

5. A public hearing is not necessary.

6. The application should be granted to the extent set forth in the order which follows.

The action taken is for the purposes of this proceeding only and is not to be construed as indicative of amounts to be included in proceedings for the determination of just and reasonable rates.

The following order should be effective on the date of signature and payment of the fee set by PU Code Section 1904(b) to enable SPCC to issue its securities expeditiously.

O R D E R

IT IS ORDERED that:

1. The issuance by Southern Pacific Communications Company (SPCC) of its $76,140,000 aggregate principal amount of promissory

notes described in the application is exempted from the California's competitive bidding rule set forth in Decision 38614, dated January 15, 1946, as amended, in Case 4761.

2. On or after the effective date of this order and on or before December 31, 1982, SPCC may issue its notes in an aggregate principal amount not to exceed $76,140,000, in accordance with the terms and conditions as described in the application, or may issue, sell, and deliver these securities by means of a competitive offering.

3. SPCC is authorized to pay on such notes an interest rate in excess of the maximum annual interest rate otherwise permitted under the California Usury Law, as contained in Article XV of the California Constitution and the Usury Law Initiative Act, if market conditions so require.

4. Neither SPCC nor any person purporting to act on its behalf shall at any time assert in any manner, or attempt to raise as a claim or defense in any proceeding, that the interest on the notes exceeds the maximum permitted to be charged under the California Usury Law or any similar law establishing the maximum rate of interest that can be charged to or received from a borrower.

5. SPCC shall use the proceeds from the borrowings authorized for the purposes stated in the application.

6. SPCC shall file the reports required by General Order Series 24.

7. Within 30 days after the issuance and sale of the proposed debt securities authorized, SPCC shall file with the Commission a report setting forth the reason that SPCC believes the resulting interest rate and cost of money were advantageous to the company and its ratepayers.

This order shall become effective when SPCC pays $44,070, the fee set by PU Code Section 1904(b).

Dated JUL 21 1982, at San Francisco, California.

JOHN E. BRYSON
President
RICHARD D. GRAVELLE
VICTOR CALVO
PRISCILLA C. CREW
Commissioners

Commissioner Leonard M. Grimes, Jr., being necessarily absent, did not participate.

PUBLIC UTILITIES COMMISSION
STATE OF CALIFORNIA
PAID
05512
JUL 26 1982
$44,070.00
By

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

Joseph E. Bodovitz, Executive Director