RR/TC/ARM/WPSC

ORIGINAL

Decision 82 09 070 SEP 22 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 $50,000,000 aggregate principal amount of its 17% Notes due 1997 and to exempt such Notes from competitive bidding.	Application 82-07-62 (Filed July 29, 1982)

OPINION

Southern Pacific Communications Company (SPCC) seeks authority to issue promissory notes (Notes) in the aggregate principal amount of up to $50,000,000 and an exemption from the Commission's competitive bidding rule.

Authority is requested under Sections 817 and 818 of the Public Utilities (PU) Code. Notice of the filing of the application was published on the Commission's Daily Calendar of August 3, 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 (affirmed by 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.

SPCC proposes to borrow $50,000,000 and issue its Notes in an aggregate principal amount of up to that sum. A detailed explanation of the terms and conditions of this proposed note financing is set forth in a document attached as Exhibit B to the application. The proposed Notes will be general obligations of SPCC; will not be secured by a mortgage or other lien on any operating properties or other assets of SPCC; and will be subject to a cash deficiency agreement between Southern Pacific Company, SPCC, and the lenders. The cash deficiency agreement provides that Southern Pacific shall be liable for any cash deficiency of SPCC, if the utility is unable to discharge its obligations under the proposed Notes. The application indicates that without the cash deficiency agreement, SPCC could not obtain the loans at the indicated rates of interest.

The proposed Notes will be issued in an aggregate principal amount of up to $50,000,000 and for terms up to 15 years; will be payable at their maturity in 1997; and will bear an interest rate of 17% per annum, payable semiannually. SPCC will be obligated to make payments of $5,000,000 annually, commencing in 1988 and in each year thereafter until 1997. The balance of $5,000,000 will be paid at maturity. The proposed Notes will be issued to the following entities and in the amounts as shown:

Lender	Amount
Aetna Life Insurance Company	$10,000,000
Teachers Insurance & Annuity Association of America	12,000,000
Connecticut General Life Insurance Company	7,000,000
Mutual of New York	7,000,000
United of Omaha Life Insurance Company	7,000,000
CNA Insurance Company	3,000,000
Canada Life Insurance Company	2,000,000
Woodmen of the World Life Insurance Company	2,000,000
Total	$50,000,000

The application states that SPCC proposes to use the proceeds from issuance of the proposed Notes to implement its capital investment and expenditure program which will expand its existing microwave radio communications system and will add switching, transmission, and multiplex equipment. Specifically, SPCC proposes to overbuild parts of its existing system and to construct new microwave radio systems principally between

San Bernardino, California, Phoenix and Tucson, Arizona, and El Paso, Texas in the southwest; and between Denver, Colorado, Amarillo and Austin, Texas, and intermediate points in the mid- and southwest. These overbuilds and new construction are required to meet SPCC's growing customer demands for switched communications services.

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, SPCC 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. SPCC commenced interstate common carrier communications service on December 26, 1973. SPCC generated a positive cash flow and earned an operating profit of $34.1 million for the year 1981. This profitable trend has continued through the first two quarters of 1982. However, at the present time, SPCC does not have a history of earnings necessary to commend securities to the investing public and to meet rating standards acceptable to SPCC. However, due to confidence in SPCC and its proposed operations, the Lenders set forth here are prepared to loan necessary funds upon the terms stated in Exhibit B, which are believed by SPCC to be more advantageous than any loan financing which could be obtained by SPCC through competitive bidding.

"Greater flexibility is obtained by placing this financing privately with the Lenders rather than making 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 placement of securities, including privately negotiated loans, have been widely adopted for the financing of new companies. Furthermore, the Lenders have considerable knowledge of SPCC's existing and proposed communications system and business operations by reason of prior negotiations of the proposed financing and involvement of some of the Lenders in previous Note financings with SPCC.

"SPCC's investment banking representative Morgan Stanley & Co., believes, and it is the considered judgment of SPCC, that under present market conditions, loans on as favorable terms as the proposed financing cannot be obtained through the public offering of SPCC's securities, or by competitive bidding. Because of the present uncertainty of the investment industry, SPCC believes that a 17% per annum interest rate is favorable for 15-year securities."

The Revenue Requirements Division believes that the proposed financings are reasonable, under current market conditions and SPCC's short history. The Communications Division has also reviewed the application and affirms that the proposed financings are necessary to support SPCC's future growth objectives.

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 the 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 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 the Notes. 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. Applicant 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 would be 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 and the deferred installment payments are favorable to SPCC under current market conditions.

5. The proposed cash deficiency agreement between Southern Pacific Company, SPCC, and the lenders is reasonable.

6. The issuance of the proposed Notes should not be required to be effective through competitive bidding.

7. The money, property, or labor to be procured or paid for by the Notes authorized 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.

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

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 Section 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 authority granted is for the purpose 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 Notes expeditiously.

O R D E R

IT IS ORDERED that:

1. The issuance of promissory notes (Notes) by Southern Pacific Communications Company (SPCC) in the aggregate principal amount of up to $50,000,000 is exempted from the Commission's competitive bidding rule set forth in Decision 38614, dated

55 January 15, 1946, ~~as amended,~~ in Case 4761, as amended.

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 $50,000,000, 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 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 Notes, 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.

8. This order shall become effective when SPCC pays $31,000, the fee set by PU Code Section 1904(b).

Dated SEP 22 1982 at San Francisco, California.

JOHN E. BRYSON
President
RICHARD D. GRAVELLE
LEONARD M. GRIMES, JR.
VICTOR CALVO
PRISCILLA C. CREW
Commissioners

PUBLIC UTILITIES COMMISSION
STATE OF CALIFORNIA
PAID
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$31,000.00
By

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

Joseph E. Bodovitz, Executive Director