RR/TC/SR/WPSC

Decision 83 05 035 MAY 18 1983

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Continental Telephone Company of California, a corporation, for an order authorizing it to issue and sell up to $20,000,000 of its First Mortgage Bonds, in one or more series and to execute one or more supplemental indentures.	Application 83-03-22 (Filed March 7, 1983)

OPINION

Continental Telephone Company of California (Continental), requests authority under Public Utilities (PU) Code Sections 816 through 830 and 851 for the following:

1. To issue and sell, through negotiated private placement or competitive bidding, its First Mortgage Bonds (New Bonds), in one or more series in an aggregate principal amount up to $20,000,000, and

2. To execute and deliver one or more indentures supplemental to its First Mortgage Indenture.

Notice of the filing of the application appeared on the Commission's Daily Calendar of March 11, 1983. No protests have been received.

Summary of Decision

This decision authorizes Continental to issue and sell its New Bonds for the purpose of refunding part of its short-term indebtedness, all of which has been spent by Continental for capital additions and improvements.

Continental, a California corporation (a subsidiary of Continental Telecom Inc., a Delaware corporation), is primarily engaged in the business of furnishing local and toll telephone service in portions of California, Nevada, and Arizona.

For the 12 months ended December 31, 1982, Continental reported it generated total operating revenues of $190,212,595 and net income of $27,573,452 shown as part of Exhibit A, attached to the application.

Continental's Balance Sheet as of December 31, 1982, also shown as part of Exhibit A is summarized as follows:

Assets	Amount
Net Telephone Plant	$388,752,286
Investments and Other Property	628,096
Current Assets	38,346,564
Deferred Charges	955,382
Total	$428,682,328
Liabilities and Equity	
Common Equity	$168,300,041
Preferred Stock	13,534,100
Long-Term Debt	179,298,071
Current Liabilities	42,659,493
Deferred Credits	24,890,623
Total	$428,682,328

Continental, with the assistance of one or more investment bankers, intends to negotiate for the private placement of the New Bonds for issuance late in 1983, at a time best coinciding with its financing needs. In addition, Continental requests alternative authority to sell the New Bonds in one or more competitive offerings should its view of market conditions change prior to commitment for a sale of the New Bonds. In the event of a private placement, the terms of the New Bonds will be fixed at the time of negotiation and will be embodied in a purchase agreement in a form substantially similar to that filed in connection with Application (A.)61139, which Continental expects to execute within a reasonable time after negotiations are completed, even if delivery of the New Bonds is delayed for several months.

Continental's capital ratios as of December 31, 1982 and adjusted to December 31, 1983 on a pro forma basis to give effect to:

1. The proposed issuance and sale of $20,000,000 of New Bonds.

2. The minimum estimated increase in reinvested earnings in 1983.

3. Retirements of Long-Term Debt and Preferred Stock

are as follows:

	December 31, 1982 Recorded	December 31, 1983 Pro Forma
Common Stock Equity	46.6%	47.1%
Preferred Stock	3.7	3.5
Long-Term Debt	49.7	49.4
Total	100.0%	100.0%

The proceeds of the sale of the New Bonds will be applied to retire short-term indebtedness incurred to partially and temporarily finance Continental's construction program. Continental estimates that its indebtedness to the holders of short-term obligations will exceed the proceeds of the New Bonds at the time the New Bonds are issued. All proceeds of the short-term obligations will have been spent by Continental for capital additions and improvements. If Continental sells the New Bonds in a principal amount in excess of short-term indebtedness outstanding at the time of sale, the excess proceeds will be used to reimburse Continental for moneys actually expended from income or other moneys in its treasury, and not obtained from the issue of its securities for construction, completion, extensions or improvement of its utility properties.

Continental states in its application that it believes, in addition to authorization of a competitive offering an exemption from the competitive bidding rule should be granted in order to permit a negotiated private placement of the New Bonds. This would allow Continental reasonable flexibility in planning for the New Bond financing and the retirement of its short-term debt. Continental states that it believes it can sell the New Bonds at a cost as low, if not lower, than would prevail if the New Bonds were sold at competitive bidding and that this will result in the lowest cost to its ratepayers. Based on this belief, Continental states that it would be in the public interest to exempt the sale of New Bonds from the Commission's competitive bidding requirements.

Continental requests an exemption for the proposed sale of the New Bonds from the Commission's competitive bidding rule established by Decision (D.)38614 dated January 16, 1946 as amended from time to time in Case 4761. Continental has set forth in A.59874 and supplemental information filed in A.60262 and A.61139, the numerous reasons why it believes it can sell the New Bonds at a cost as low if not lower, than would prevail if the New Bonds were sold at competitive bidding and that this will result in the lowest cost to its ratepayers. Continental believes these reasons are still pertinent. Continental, as part of this application, submitted by letter from their attorney dated April 1, 1983 the following additional reasons for an exemption from the competitive bidding rule:

1. Public issues have higher fixed costs which result in a higher effective interest rate than privately placed bonds.

2. Fixed costs for private placements are less because they are exempt from registration under the Securities Act of 1933. This reduces legal fees, printing costs, and underwriter fees.

3. Another consideration is the maintenance costs of a public issue. In addition to current reporting requirements, the Tax Equity and

Fiscal Responsibility Act of 1982 (TEFRA) will add more costs. Unlike private placements which are held by institutions, public issues are partly held by individuals. TEFRA requires that 10% be withheld on all interest payments that exceed $500 annually to all nonexempt persons. Administration of TEFRA will generate new costs that will be passed on to ratepayers.

4. Continental's debt issuance expense clearly shows that the cost of publicly placed bonds were twice the cost of privately placed bonds. Continental's historic weighted average debt expense for privately placed bonds is .7897% and for competitively placed issues is 1.5983% of the bond's face value.

In D.91984 dated July 2, 1980 for San Diego Gas & Electric Company's 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 Continental intends to sell the proposed New Bonds by private placement on terms which will be negotiated after the issuance of this decision and because of the Commission's

Revenue Requirements Division's conclusion and belief that the New Bonds will be sold at a cost as low, if not lower, than would prevail if the New Bonds were to be sold at competitive bidding, we are of the opinion that applying the Commission's competitive bidding requirements and conditions set forth in D.91984 in this proceeding would not be in the best interest of Continental or its ratepayers. The rule would not operate to ensure that Continental's sale of the New Bonds would be at the most favorable cost of money. Further, Continental is a small independent telephone company when compared to other independent telephone companies in the nation. It is not a well known company outside of California, nor are its debt securities highly rated (Standard and Poor's A— and Moody's A1). Also, Continental's proposed $20,000,000 debt offering is not of sufficient size to attract the interest of a large number of major bidders to form an adequate investment syndicate of major bidders. However, in order not to limit Continental's options, we will grant Continental the authority to issue the proposed New Bonds by means of a competitive offering or private placement according to Continental's estimation of where the most favorable opportunity lies.

If the New Bonds are sold by means of a negotiated private placement, Continental is put on notice that in its next 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 the interest expense if it is determined that the cost of money incurred was not the most prudent. We will also require Continental to provide us with a showing of why it believes that the resulting interest rate and cost of money were the most advantageous to the company and its ratepayers. We will require this showing within a reasonable period of time after the issuance and sale of its New Bonds.

Continental's estimated net construction expenditures for the calendar years 1983 and 1984 will approximate $61,100,000 and $61,800,000, respectively. Continental has provided in detail its construction program estimated as follows:

Purpose	Estimated Construction Expenditures (Dollars in Thousands)	
Construction and Plant Expenditure (Includes Removal Cost):	1983	1984
Station Apparatus and Connections	$ 1,895	$ 2,362
Other Operations (Key Systems, Special Systems, Furniture, and Work Equipment)	2,512	1,655
Outside Plant	23,880	23,025
Central Office Equipment	20,713	16,823
Land and Buildings	5,286	4,513
Other	11,897	17,283
Overheads	1,636	1,714
Total Construction and Plant Expenditures	$67,819	$67,375
Less Salvage Value	(6,628)	(5,613)
Net Construction and Plant Expenditures	$61,191	$61,762

Continental reports that as of December 31, 1982 its unreimbursed construction expenditures amounted to $167,271,255 shown in supplemental data provided to the Commission in connection with this application.

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

The Commission's Revenue Requirements Division has analyzed the financial data provided by Continental. The Division determined that cash generated from internal operations will provide about 89% of the capital requirements estimated for 1983. The Division has concluded the proposed financing is necessary to help Continental meet its capital requirements.

Findings of Fact

1. Continental, a California corporation, operates under the jurisdiction of this Commission.

2. The proposed New Bonds would be for proper purposes.

3. Continental has need for external funds for the purposes set forth in its application.

4. Continental believes it will be able to obtain an effective interest rate on its New Bonds through a negotiated private placement for delayed delivery in 1983, as low as, or lower than, it could obtain from a competitive bid public offering of the New Bonds and should be authorized to proceed in the manner described in the application.

5. Continental should be authorized to issue and sell up to $20,000,000 aggregate principal amount of the New Bonds, either through private placement or competitive bidding upon terms and at a time which Continental determines to be most advantageous to it and its ratepayers.

6. 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.

7. The proposed security issue is for lawful purposes and the money, property, or labor to be obtained by it is required for these purposes. Proceeds from the security issue may not be charged to operating expenses or to income.

8. The proposed supplemental indentures would not be adverse to the public interest.

9. There is no known opposition 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 which follows.

The action taken is for the purposes of this proceeding only and is not to be construed as indicative of the 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 to enable Continental to issue and sell its New Bonds expeditiously.

ORDER

IT IS ORDERED that:

1. Continental Telephone Company of California (Continental), on or after the effective date of this order and on or before June 30, 1984, may issue, sell and deliver for cash, in one or more series, its First Mortgage Bonds, in an aggregate principal amount of up to $20,000,000 by private placement, to be negotiated as described in the application or by competitive bidding. These sales are exempted from the Commission's competitive bidding rule.

2. Continental may execute and deliver one or more supplemental indentures in substantially the same form as that filed in connection with A.61139 filed December 18, 1981, with any changes that are required to reflect the terms of the First Mortgage Bonds. As soon as available, Continental shall file with the Commission the definitive form of any supplemental indenture.

3. Continental shall apply the proceeds from the sale of its First Mortgage Bonds to the purposes set forth in the application.

4. Promptly after Continental ascertains the price, interest rate and other terms pertaining to the First Mortgage Bonds, the utility shall notify the Commission in writing.

5. If the First Mortgage Bonds, in one or more series, or any series of them are sold on a private placement basis, within 30 days after their issuance and sale, Continental shall file with the Commission a report setting forth the reasons why it believes the resulting interest rate and cost of money to the company were the most advantageous to the company and its ratepayers.

6. If the First Mortgage Bonds, in one or more series or any series of them, are sold by competitive bidding, as soon as available, Continental shall file with the Commission three copies of its final prospectus relating to the issuance of the New Bonds.

7. If the First Mortgage Bonds, in one or more series, or any series of them are sold on a private placement basis, as soon as available, Continental shall file with the Commission a conformed copy of the purchase agreement.

8. Continental shall file the reports required by General Order Series 24.

9. This order shall be effective upon payment of $2,500, the fee prescribed by PU Code Section 1904(b) after giving credit of $11,000 based on D.92878 dated April 7, 1981 in A.60262, and $2,500 based on D.82-02-091 dated February 17, 1982 in A.61139.

Dated MAY 18 1983, at San Francisco, California.

LEONARD M. GRIMES, JR.
President
VICTOR CALVO
PRISCILLA C. GREW
DONALD VIAL
Commissioners

PUBLIC UTILITIES COMMISSION
STATE OF CALIFORNIA
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I CERTIFY [illegible] THIS DECISION
WAS AP[illegible] THE ABOVE
COMMISS[illegible] TODAY.

Joseph E. Bodovitz, Executive Director