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Decision No. 89672 NOV 28 1978 ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY, to issue and sell $200,000,000 par value of non-voting preferred shares.	Application No. 58428 (Filed October 23, 1978)

O P I N I O N

The Pacific Telephone and Telegraph Company (Pacific Telephone) requests authority to issue and sell $200,000,000 aggregate par value of non-voting cumulative preferred shares, consisting of 8,000,000 shares having a par value of $25 per share.

Such shares would constitute the third and fourth series of Pacific Telephone's class of non-voting preferred shares. This class of preferred shares is referred to herein as "non-voting" shares to distinguish it from the previously existing class of preferred shares, which is referred to as "voting" preferred shares. The class of non-voting preferred shares, however, has limited voting rights in the event of certain defaults in dividends or certain other changes affecting its interests, as provided in Pacific Telephone's Articles of Incorporation, as amended. The holders of non-voting preferred shares have no preferential right to subscribe for newly issued shares of any class of common or preferred stock, or rights thereto, or any securities convertible into such shares.

The holders of shares of the proposed third (the 8.10% Series, consisting of 3,115,000 shares) and fourth (the 8.60% Series, consisting of 4,885,000 shares) series of non-voting preferred shares will be entitled to receive, when and as declared by the Board of Directors of the corporation, dividends at the rate of 8.10% and 8.60% respectively, of the par value thereof per annum, and no more, payable quarterly. Such dividends will be cumulative with respect to each share from the date of issuance thereof. Any partial payment of dividends would be made on a pro rata basis for all issues of preferred shares (including voting preferred and non-voting preferred).

The shares of the 8.10% Series may be redeemed at the option of Pacific Telephone, in whole or in part, upon thirty (30) days' notice, on any date on or after December 15, 1983 at per share prices declining annually and proportionately from par plus a premium equal to $0.90 to and including December 14, 1984 to $25 on December 15, 1987, plus in each case, dividends accrued but unpaid to the date fixed for redemption. However, shares of the 8.10% Series will not be optionally redeemable through the issuance of debt at an interest cost (calculated in accordance with generally accepted financial practice) of less than 8.10% per annum or through the issuance of shares ranking prior to the common shares and having a dividend cost of less than 8.10% of the offering price of such shares.

The shares of the 8.60% Series may be redeemed at the option of Pacific Telephone, in whole or in part, on any date upon at least thirty (30) days' notice at per share prices declining annually and proportionately from par plus a premium equal to the dividend to and including December 14, 1979, to $25 on December 15, 1997, plus, in each case, dividends accrued but unpaid to the date fixed for redemption. Prior to December 15, 1988, such shares will not be optionally redeemable through the issuance of debt at an interest cost (calculated in accordance with generally accepted financial practice) of less than 8.60% per annum or through the issuance of shares ranking prior to the common shares and having a dividend cost of less than 8.60% of the offering price of such shares.

The shares of both series will be subject to redemption through the operation of a sinking fund. Pacific Telephone will be required to set aside in cash, annually on December 15, commencing in 1984, an amount sufficient to redeem 623,000 shares of the 8.10% Series, and annually on December 15, commencing in 1983 and ending in 1990, an amount sufficient to redeem 305,312 shares of the 8.60% Series, and on each December 15 thereafter, an amount sufficient to redeem 305,313 shares of the 8.60% Series, in each case at a price of $25 per share plus dividends accrued but unpaid to the date fixed for redemption. Pacific Telephone will have the noncumulative option on any such annual redemption date to redeem an additional 623,000 shares and 305.312 shares of the 8.10% Series and 8.60% Series, respectively, provided, however, that the total number of shares of each series additionally so redeemed shall be limited to 934,500 shares of the 8.10% Series and 1,465,500 shares of the 8.60% Series.

No cash dividends may be paid or declared on common shares if any annual redemption payment or any dividend on the shares of either series is in arrears.

Pacific Telephone intends to issue and sell said non-voting preferred shares by means of private placement to a limited number of institutional investors. The shares will not be registered under the Securities Act of 1933. Pacific Telephone has engaged two investment banking firms to place the shares directly. Pacific Telephone anticipates that some shares of each series will be issued and payment therefor received on or about December 13, 1978; the remaining shares of each series will be issued and payment therefor received on or about March 1, 1979.

In its application, Pacific Telephone states that it has need to raise capital to enable it to meet its construction budget. The Operations Division of the Commission staff extensively evaluated Pacific Telephone's construction requirements for the twelve months ending December 31, 1978 in connection with Application No. 58223 and concluded that expenditures exceeding $1,400,000,000 are reasonable. The staff estimates for the years 1978 and 1979 indicate the need for $2,916,300,000 gross construction outlays related to customer growth and movement, and for plant modernization and replacement as follows:

Item	
Customer growth	$1,738,100,000
Customer movement	582,000,000
Plant modernization	381,300,000
Plant replacement	214,900,000
Total	$2,916,300,000

Review of these estimates confirms the necessity for such expenditures; the Operations Division reserves the right, however, to reconsider the reasonableness of any construction expenditures in future rate proceedings.

Pacific Telephone proposes to use the proceeds received from the issuance of these non-voting preferred shares for the reimbursement of the treasury, to the extent such proceeds are sufficient therefor, for monies actually expended since October 31, 1922, from income and from other treasury funds, which expenditures on September 30, 1978, amounted to the sum of $2,354,105,565, said sum having been expended for the acquisition of property and for the construction, completion, extension and improvement of plant and facilities. Exhibit B attached to the application contains a tabulation of such unreimbursed expenditures which are summarized herein as follows:

		Amount
Total capital expenditures, October 31, 1922 to September 30, 1978		$12,070,432,144
Deduct proceeds of:		
Stock issues	$2,911,814,207	
Promissory notes	387,486,000	
Funded debt	3,947,781,100	
Other	147,082,442	
Total deductions		7,394,163,749
Balance obtained from other sources		4,676,268,395
Less: Reserve for depreciation		2,322,162,830
Unreimbursed balance		$ 2,354,105,565

Pacific Telephone's estimated capital ratios as of December 31, 1978 and its pro forma capital ratios giving effect to the proposed issue of $200,000,000 par value of preferred shares are as follows:

	December 31, 1978	
	Estimated	Pro Forma
Debt	52.6%	50.3%
Preferred shares	4.3	6.6
Common equity	43.1	43.1
Total	100.0%	100.0%

In Decision No. 89468, dated October 3, 1978, in Application No. 58310, we prohibited Pacific Telephone from using debenture proceeds to finance its wholly owned subsidiary, Bell Telephone Company of Nevada. We stated the following in that Decision:

> "Section 817 of the Public Utilities Code provides that the proceeds of security issues may be used for the purposes stated therein and not others. The section does not contemplate the use of any of the proceeds of a security issue for the benefit of a wholly owned subsidiary of a utility in another state."

We ordered Pacific Telephone not to use the proceeds, from the issuance of the debentures, for the benefit of, or to reimburse its treasury on account of expenditures in behalf of Bell Telephone Company of Nevada. Accordingly, the decision in this proceeding will contain a similar restriction.

After considering the matter, the Commission finds that:

1. The proposed issue and sale of not to exceed $200,000,000 par value of non-voting preferred shares is for a proper purpose if the proceeds thereof are not used for the benefit of Bell Telephone Company of Nevada.

2. Applicant has need for the external funds to be raised by the proposed issue and sale of non-voting preferred shares.

3. The terms and conditions of the proposed issue and sale of each series of such non-voting preferred shares, including the redemption provisions, are just and reasonable and in the public interest.

4. The issue and sale of the non-voting preferred shares by means of private placement is just and reasonable and in the public interest.

5. The money, property or labor to be procured or paid for by the issue and sale of the non-voting preferred shares herein authorized is reasonably required for the purpose specified herein, which purpose is not, in whole or in part, reasonably chargeable to operating expenses or to income.

6. It is in the public interest to authorize applicant to obtain adequate financing through the issue and sale of its non-voting preferred shares, and there is no reason to delay granting the requested authority.

On the basis of the foregoing consideration and findings, we conclude that the application should be granted. A public hearing is not necessary. The authorization granted herein 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.

ORDER

IT IS ORDERED that:

1. The Pacific Telephone and Telegraph Company is hereby authorized to issue and sell for cash, on or before June 30, 1979, not to exceed $200,000,000 par value of non-voting preferred shares, in the form and manner as set forth in this opinion.

2. The Pacific Telephone and Telegraph Company shall use the proceeds to be derived from the issuance and sale of said non-voting preferred shares to reimburse, so far as possible, its treasury for funds expended as set forth in this opinion, except that no part of the proceeds of such issuance shall be used for the benefit of, or to reimburse its treasury on account of expenditures in behalf of Bell Telephone Company of Nevada.

3. Within 30 days after all the non-voting preferred shares herein authorized have been issued and payment therefor received, The Pacific Telephone and Telegraph Company shall file with the Commission a letter reporting the number of such shares issued and sold and the use of the proceeds therefrom substantially in the format set forth in Appendix C of Decision No. 85287, dated

December 30, 1975, in Application No. 55214 and Case No. 9832. It shall also include in this letter the amounts of all fees paid to investment banking firms for services rendered by them in placing the shares.

4. This order shall become effective when The Pacific Telephone and Telegraph Company has paid the fee prescribed by Section 1904.1 of the Public Utilities Code, which fee is $106,000.

Dated at San Francisco, California, this 28th day of NOVEMBER, 1978.

Robert Batinovich
President

I abstain
William Symons, Jr.

Richard D. Gravelle
Claire T. Dedrick
Commissioners

Commissioner Vernon L. Sturgeon, being necessarily absent, did not participate in the disposition of this proceeding.