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Decision No. 89822 JAN 4 1979

**ORIGINAL**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of THE PACIFIC TELEPHONE )  
 AND TELEGRAPH COMPANY, to issue and )  
 sell not to exceed \$300,000,000 )  
 principal amount of Debentures and to )  
 execute and deliver an Indenture; and )  
 for an exemption of such proposed )  
 issue of Debentures from the )  
 requirements of the Competitive Bidding )  
 Rule. )

Application No. 58492  
(Filed November 30, 1978)

O P I N I O N

The Pacific Telephone and Telegraph Company (Pacific Telephone) requests authority to execute and deliver an indenture and to issue and sell, either by competitive bidding or negotiation, not to exceed \$300,000,000 principal amount of debentures having a term of not to exceed forty years.

The purpose of the proposed financing is to reimburse Pacific Telephone's treasury for moneys actually expended for capital purposes from income and from other treasury funds of Pacific Telephone and its subsidiary. Such expenditures amounted to a cumulative total of \$2,368,164,601 as of October 31, 1978, as set forth in the following summary:

	<u>Amount</u>
Total capital expenditures, October 31, 1922 to October 31, 1978	\$12,199,484,759
Deduct proceeds of:	
Stock issues	\$2,911,814,207
Promissory notes	474,760,000
Funded debt	3,947,781,100
Other	<u>147,082,442</u>
Total deductions	<u>7,481,437,749</u>
Balance obtained from other sources	4,718,047,010
Less: Reserve for Depreciation	<u>2,349,882,409</u>
Unreimbursed balance	<u>\$ 2,368,164,601</u>

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Pacific Telephone anticipates that the proceeds from the sale would be available on or about February 15, 1979. When the treasury has been reimbursed, as described above, Pacific Telephone intends to apply an equivalent amount to repayment of its then outstanding short-term borrowings.

Pacific Telephone's capital ratios as recorded on October 31, 1978 and as adjusted to give effect to (1) the sale on November 9, 1978 of \$300,000,000 of debentures authorized by Commission Decision No. 89468, dated October 3, 1978, in Application No. 58310; (2) the proposed sale of \$200,000,000 of preferred shares authorized by Commission Decision No. 89672, dated November 28, 1978, in Application No. 58428; and (3) the proposed sale of \$300,000,000 of debentures on or about February 7, 1979, together with the estimated interim debt at that date, are as follows:

	<u>October 31, 1978</u>	
	<u>Recorded</u>	<u>Pro Forma</u>
Funded debt	46.3%	50.3%
Short-term borrowings	5.5	1.3
Preferred stock	4.4	6.4
Common equity	<u>43.8</u>	<u>42.0</u>
Total	<u>100.0%</u>	<u>100.0%</u>

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.

The Operations Division of the Commission staff extensively evaluated Pacific Telephone's construction requirements for the twelve months ended December 31, 1978 in connection with Application No. 58223, filed July 15, 1978, for a general increase in rates, and concluded that expenditures exceeding \$1,400,000,000 were reasonable. Company estimates for the years 1978 and 1979 indicate the need for \$3,763,000,000 gross construction outlays related to customer growth and movement, and for plant modernization and replacement as follows:

<u>Item</u>	
Customer growth	\$2,374,000,000
Customer movement	607,000,000
Plant modernization	518,000,000
Plant replacement	<u>264,000,000</u>
Total	<u>\$3,763,000,000</u>

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's cash requirement for 1979, estimated as of November 30, 1978, is as follows:

	<u>1979</u> (Thousands of Dollars)
Funds used or required for construction expenditures	\$1,949,437
Funds required for maturing debt:	
20 month 6-1/4% Notes due February 1, 1979	75,000
27 year 3-1/4% Debentures due November 15, 1979	<u>35,000</u>
Total funds used or required for construction expenditures and maturing debt	\$2,059,437
Less: Estimated cash available from internal sources	<u>1,059,437</u>
Additional new money required from outside sources	<u><u>\$1,000,000</u></u>

The Finance Division of the Commission's staff has analyzed the above cash requirement forecast, attached to the application as part of Exhibit A, and determined that internally generated funds will provide only 51 percent of the cash requirements estimated for 1979. The Finance Division has concluded that the proposed bond issue will therefore be necessary to help meet the company's estimated cash requirements.

The proposed debentures are to be issued under an indenture between Pacific Telephone and Marine Midland Bank, as Trustee. Among other things, the indenture provides that the debentures may not be redeemed at Pacific Telephone's option until on or after a date five years from the date of the indenture. Pacific Telephone states that inclusion of this restriction would result in a lower cost of money for its debentures and would broaden the market further than would be the case if such provision were not included.

Pacific Telephone requests exemption from competitive bidding requirements because "substantial demands for funds, both in the private and public sectors, coupled with investors' expectations of high inflation rates have resulted in high interest rates and a volatile market" as well as other factors. Pacific Telephone has submitted evidence that its November 9, 1978 sale of \$300,000,000 of debentures on a negotiated basis achieved the lowest cost of money at which that issue could have been successfully marketed. Attached to the application as Exhibit C is a letter to the company from Salomon Brothers, which incorporates collectively the views of Salomon Brothers, Bache Halsey Stuart Shields Incorporated, The First Boston Corporation, Merrill Lynch, Pierce, Fenner and Smith Incorporated, and Dean Witter Reynolds Inc. These investment banking firms were the managers of the November 9, 1978 negotiated sale.

If future market conditions are adverse, Pacific Telephone proposes to sell the debentures by means of a negotiated underwriting by a nationwide group of investment banking firms. The underwriters would purchase all of the debentures, in accordance with an underwriting agreement substantially in the form of the purchase agreement attached to the application as part of Exhibit D.

However, if future market conditions so warrant, Pacific Telephone desires alternative authority to sell them pursuant to competitive bidding in the event of substantially improved market conditions.

We are persuaded that the present unsettled market conditions, the size of the offering and other factors justify a negotiated offering of the securities. We do not find, however, that a sale on a competitive bid basis is always necessarily in the public interest. This decision is not intended to modify the

competitive bidding rule as initially set out in Decision No. 38614 (46 Cal.R.C. 281 (1946)), as amended by the Commission in subsequent decisions in Case No. 4761.

Pacific Telephone is also concerned that the effective interest rate on the proposed debentures may exceed 10% per annum, the maximum generally permitted under the California Usury Law, and requests a finding that sale of the debentures at an effective interest rate in excess of 10% would be in the public interest.

In Decision No. 83411, dated September 4, 1974, in Application No. 55080 (Southern California Gas Company), Decision No. 88612, dated March 21, 1978 in Application No. 57871 (San Diego Gas & Electric Company), and Decision No. 89468, dated October 3, 1978, in Application No. 58310 (The Pacific Telephone and Telegraph Company), among others, this Commission held that the California Usury Law does not apply to the issuance and sale of securities authorized by this Commission. We reaffirm this holding and conclude that if the interest limitation of the California Usury Law is exceeded but it is determined that the transaction, whether negotiated or by competitive bid, is the best the utility can obtain because of market conditions, then the public interest requires this Commission to authorize the issuance and sale of the debt instruments.

After consideration the Commission finds that:

1. Pacific Telephone is a California corporation operating under the jurisdiction of this Commission.
2. The proposed debenture sale is for proper purposes if the proceeds thereof are not used for the benefit of Bell Telephone Company of Nevada.

3. The utility has need for external funds for the purposes set forth in these proceedings.
4. The terms and conditions of the proposed issue and sale of Debentures, including the restricted redemption provision, are just and reasonable and in the public interest.
5. The money, property or labor to be procured or paid for by the issuance and sale of the debentures herein authorized is reasonably required for the purposes specified herein, which purposes, except as otherwise authorized for accrued interest, are not, in whole or in part, reasonably chargeable to operating expenses or to income.
6. The sale of the proposed debentures should not be required to be at competitive bidding.
7. The debentures being unsecured, no California property would become encumbered thereby.
8. If prevailing market conditions necessitate that applicant's debentures be issued and sold with a rate of interest exceeding the limitations provided in Article XV of the California Constitution, then the public interest requires that the Commission authorize said issuance and sale irrespective of limitations contained in the California Usury Law.
9. Pursuant to 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.
10. The Legislature has conferred upon the Public Utilities Commission the authority to regulate the issuance of public utility securities, including evidences of indebtedness, and to prescribe restrictions and conditions as it deems reasonable and necessary (Sections 816 et seq. of the Public Utilities Code).

11. Pursuant to 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.
12. 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 thereof are the best Pacific Telephone can obtain because of market conditions, Pacific Telephone, its assignees or successors in interest will have no occasion to and cannot assert any claim or defense under the California Usury Law; further, and necessarily, because of lawful issuance by Pacific Telephone of debentures in compliance with authorization by the Public Utilities Commission, persons collecting interest on such authorized debentures are not subject to the Usury Law sanctions.

On the basis of the foregoing findings we conclude that the application should be granted. There is no known opposition to the application and no reason to delay granting the authority requested. Because Pacific Telephone plans to issue and sell the proposed debentures on or about February 7, 1979, the effective date of this order should be the date on which the company has paid the prescribed fee. 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.



O R D E R

IT IS ORDERED that:

1. The Pacific Telephone and Telegraph Company may issue, sell and deliver, on or before July 31, 1979, not to exceed \$300,000,000 principal amount of debentures in accordance with the application and the terms and provisions of a debenture purchase agreement substantially in the form filed as Exhibit D to the application, with a term not to exceed forty years and with a maturity date appropriate to the actual sale date.

2. Said sale is hereby exempted from the Commission's competitive bidding rule set forth in Decision No. 38614, dated January 15, 1946, as amended.

3. The Pacific Telephone and Telegraph Company is authorized to execute and deliver an indenture substantially in the form filed as Exhibit B to the application, with maturity, interest payment and other relevant dates appropriate to the actual sale date of said debentures.

4. The Pacific Telephone and Telegraph Company is authorized to pay on such debentures 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.

5. Neither The Pacific Telephone and Telegraph Company 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 said debentures 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.

6. The Pacific Telephone and Telegraph Company shall use the proceeds of the issuance and sale of not exceeding \$300,000,000 principal amount of said securities for the purposes stated in the application (accrued interest may be used for general corporate purposes), except that no part of the proceeds of such issuance shall be used for the benefit of, or to reimburse the treasury of The Pacific Telephone and Telegraph Company on account of expenditures in behalf of Bell Telephone Company of Nevada.

7. Promptly after The Pacific Telephone and Telegraph Company determines the price or prices and interest rate or rates pertaining to the securities herein authorized, it shall notify the Commission thereof in writing.

8. In the event The Pacific Telephone and Telegraph Company utilizes competitive bidding, in lieu of the notification required by paragraph 7 hereof the company shall file with the Commission a written report showing as to each bid received, the name of the bidders, the price, the interest rate, and the cost of money to it based upon said price and interest rate.

9. As soon as available, The Pacific Telephone and Telegraph Company shall file with the Commission three copies of the final prospectus pertaining to said debentures.

10. Within 30 days after selling the debentures herein authorized to be issued and sold, The Pacific Telephone and Telegraph Company shall file with the Commission a letter reporting the amount of such debentures 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.

11. This order shall become effective when The Pacific Telephone and Telegraph Company has paid the fee prescribed by Section 1904(b) of the Public Utilities Code, which fee is \$156,000.

Dated at San Francisco, California, this 4th day of JANUARY, 1979.

*Robert R. Lerman*  
President  
*George D. ...*  
*Clare L. ...*  
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Commissioners

