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Decision No. 90884 OCT 10 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. 59090 (Filed August 23, 1979; amended September 7, 1979)

William F. Anderson, Attorney at Law, for The Pacific Telephone and Telegraph Company, applicant.
Sidney J. Webb, for himself, protestant.

O P I N I O N

The Pacific Telephone and Telegraph Company (Pacific Telephone) seeks authority (a) to execute and deliver an indenture containing a five-year restricted redemption provision; (b) to issue and sell, either through competitive bidding or negotiation with a nationwide group of investment banking firms, not exceeding $300,000,000 principal amount of debentures having a term of not exceeding 40 years; and (c) to pay an interest rate in excess of the maximum permitted under the California Usury Law.

After due notice, on September 14, 1979, a public hearing in the above-entitled matter was held before Administrative Law Judge Kenji Tomita in San Francisco and the matter was submitted.

The purpose of the proposed financing is to reimburse Pacific Telephone's treasury for (a) the retirement of its $35,000,000, 3-1/4 percent debentures due November 15, 1979; and (b) monies actually expended for capital purposes from income and from other treasury funds of itself and of its subsidiary, Bell Telephone Company of Nevada. Such expenditures amounted to a cumulative total of $2,664,738,775 as of July 31, 1979, as set forth in the following summary:

		Amount
Total capital expenditures, October 31, 1922, to July 31, 1979		$13,404,550,903
Deduct proceeds of:		
Stock Issues	$3,111,814,207	
Promissory notes	155,318,000	
Funded debt	4,772,781,100	
Other	147,635,231	
Total deductions		8,187,548,538
Balance obtained from other sources		5,217,002,365
Less: Reserve for Depreciation		2,552,263,590
Unreimbursed balance		$ 2,664,738,775

Pacific Telephone anticipates that the proceeds from the sale would be available on or about November 20, 1979, Accordingly, Pacific Telephone expects to apply the proceeds (other than accrued interest which would be used for general corporate purposes) toward reimbursement of the treasury as previously mentioned herein. When the treasury has been reimbursed, Pacific Telephone intends to apply an equivalent amount to repayment of its then outstanding short-term borrowings, which would otherwise total $680,000,000 by the end of 1979. Such borrowings may be further increased when this Commission approves a refund plan in connection with another matter before it.

Pacific Telephone's capital ratios, excluding short-term borrowings, as recorded on July 31, 1979, and as adjusted to give effect to the proposed sale of debentures are as follows:

	July 31, 1979	
	Recorded	Pro Forma
Funded debt	53.5%	54.8%
Preferred stock	6.4	6.2
Common equity	40.1	39.0
Total	100.0%	100.0%

Pacific Telephone's estimates for the year 1979 indicate the need for $2,238,000,000 gross construction outlays related to customer growth and movement, and for plant modernization and replacement as follows:

Item	
Customer growth	$1,338,000,000
Customer movement	405,000,000
Plant modernization	334,000,000
Plant replacement	161,000,000
Total	$2,238,000,000

Review of these estimates confirms the necessity for such expenditures; however, the reasonableness of any construction expenditures will be a matter to be determined in future rate proceedings.

The proposed debentures are to be issued under an indenture between Pacific Telephone and Irving Trust Company, 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 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 a purchase agreement substantially in the form attached to the application as part of Exhibit E.

Pacific Telephone requests exemption from competitive bidding requirements because of the size of the proposed issue and 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. Pacific Telephone states in its application that these and other factors would make preoffering efforts by a large number of underwriters and dealers essential and that such efforts could be obtained by the use of a negotiated underwriting.

Although Pacific Telephone's present plans contemplate selling the securities on a negotiated basis, Pacific Telephone desires alternative authority to sell them pursuant to competitive bidding in the event of substantially improved market conditions.

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

Mr. Robert M. Joses, treasurer for Pacific Telephone, testified for Pacific Telephone in support of its application. Mr. Joses testified that the proposed issue of 10,000,000 shares of common stock on which the shareholders voted to waive their preemptive rights had been postponed by action of Pacific Telephone's Board of Directors based on advice of the proposed lead underwriter and the Board of Directors' assessment of Pacific Telephone's extremely uncertain financial outlook stemming from the Commission's decisions ordering refunds in the "Remand Case" and reducing rates by $42 million in a rate application in which Pacific Telephone was seeking a $470 million increase. Mr. Joses further added that the disclosures required in an offering prospectus relating to Pacific Telephone's financial problems would make purchase of Pacific Telephone stock unattractive to many investors and that at the present time the common equity portion of the financial market is realistically denied Pacific Telephone.

In seeking exemption from the Commission's competitive bidding rule, witness Joses stated that the size of offering, the currently existing unstable market conditions, Pacific Telephone's single A debenture rating, and the flexibility a negotiated offering provides in completing such financing were all factors that justified the granting of an exemption.

Witness Joses further testified that based on current market conditions the interest rate on the debentures may exceed 10 percent and, therefore, requested that the Commission make appropriate findings and conclusions of law with respect to the Commission's jurisdiction and power to regulate the issuance of debt securities by public utilities and prohibition against asserting usury as a defense to the payment of interest. In addition, Mr. Joses testified that Pacific Telephone will structure the sale as a New York transaction in which the New York laws will be applicable.

Sidney J. Webb, protestant, appeared in the proceeding for himself as a stockholder of Pacific Telephone. He argued that the application should be denied in its entirety and that Pacific Telephone should be required to finance its capital requirements through issuing additional common or preferred stock or some combination thereof. Mr. Webb argued that considering Pacific Telephone's low debt ratings, high debt ratio, and prevailing high interest rates additional debt financing is not justified and increases the risk of further downgrading of debenture ratings.

With respect to Pacific Telephone's request for exemption from the Commission's competitive bidding rule, Mr. Webb argued that Pacific Telephone had failed to make a compelling showing that such exemption would be advantageous to itself and its customers; therefore, should the Commission decide to grant Pacific Telephone authority to issue the debentures, the Commission should not waive its competitive bidding requirements.

Mr. Webb also argued that there is a strong likelihood that the interest rate applicable to the proposed debentures will exceed the 10 percent per annum permitted by Article XV of the California Constitution. He further points out that in Decision No. 90419 relating to Pacific Telephone's most recent debenture issue, the Commission rejected his use of ballot arguments on the defeated usury constitutional propositions as an aid in construing constitutional amendments. In the present proceeding Mr. Webb, in attempting to strengthen his position, provided three citations[1/] which purportedly support the use of ballot arguments on defeated constitutional propositions in construing constitutional amendments.

1/ Miro v Superior Court (1970) 5 Cal. App. 3d 87, 99; California Housing Finance Agency v Elliot (1976) 17 Cal, 3d 575, 591; and California Housing Finance Agency v Patitucci (1978) 22 Cal 3d 171, 178.

Discussion

We have in the past stressed the importance of utilities maintaining a balanced capital structure in order to be financially sound, to maintain financial flexibility, and to be able to attract capital at reasonable rates. We are, therefore, deeply concerned with Pacific Telephone's postponement of its 10 million share common stock offering authorized by Decision No. 90652 on August 14, 1979, as we believe a common stock offering is necessary to balance the large debt offerings issued or planned for 1979. On the other hand, we are cognizant of recent materially important events and regulatory developments which may have an adverse effect on such common stock offering especially at a time when the capital markets are extremely unstable, which may justify a temporary postponement. We will place Pacific Telephone on notice that the Commission considers such deferral to be temporary and should Pacific Telephone seek authorization to issue additional debt securities before the common stock sale has been consummated, we will require Pacific Telephone to make a strong showing justifying such further postponement.

With respect to Pacific Telephone's request for authorization to deviate from the Commission's competitive bidding rule, we are of the opinion that the justification offered by Pacific Telephone reasonably supports the granting of such exemption in this proceeding. We do not find that a sale on a competitive basis is always in the public interest. This decision is not intended to modify the competitive bidding rule as initially set out in Decision No. 38614 (46 CRC 281 (1946)).

In Decision No. 83411, dated September 4, 1974, (Southern California Gas Company); Decision No. 88612, dated March 21, 1978, (San Diego Gas & Electric Company); and Decision No. 90419, dated

June 15, 1979, (Pacific Telephone); among others, this Commission held that the California Usury Law does not apply to the issuance and sale of securities authorized by this Commission.

Although Mr. Webb in this proceeding has provided citations in which election brochure arguments on defeated constitutional propositions were used in construing constitutional amendments to support the same arguments he offered in connection with Applications Nos. 58552 and 58844, we are not moved to change our previous holding relating to the California Usury Law and 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 utility has need of external funding and 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.

Findings of Fact

1. Pacific Telephone is a California corporation operating under the jurisdiction of this Commission.

2. The proposed debenture sale is for proper purposes.

3. Pacific Telephone has need for external funds for the purposes set forth in these proceedings.

4. The terms and conditions of the proposed issuance 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

6. The proposed debt issuance will be offered in a relatively unstable debt market.

purposes, except as otherwise authorized for accrued interest, are not, in whole or in part, reasonably chargeable to operating expenses or to income.

7. The sale of the proposed debentures should not be required to be at competitive bidding.

8. The debentures being unsecured, no California property would become encumbered thereby.

9. If prevailing market conditions necessitate that Pacific Telephone'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.

Conclusions of Law

1. 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.

2. 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.)

3. 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.

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 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.

5. Pacific Telephone has demonstrated conditions which, taken together, constitute a compelling reason for granting an

exception to the Commission's long-standing competitive bidding rule; it is forseeable that given the relatively unstable debt market conditions, the size of the proposed offering and Pacific Telephone's debenture rating that the flexibility to not use competitive bidding may result in lower debt cost.

6. Application No. 59090 should be granted.

7. 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 (Pacific Telephone) may issue, sell and deliver, on or before December 31, 1979, not exceeding $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 a part of Exhibit E 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. Pacific Telephone 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. Pacific Telephone 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 Pacific Telephone 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. Pacific Telephone 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) and may apply $35,000,000 of said proceeds to reimburse its treasury for the retirement on November 15, 1979, of its outstanding 3-1/4 percent debentures.

7. Promptly after Pacific Telephone 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 Pacific Telephone utilizes competitive bidding in lieu of the notification required by paragraph 7 hereof, Pacific Telephone 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, Pacific Telephone shall file with the Commission three copies of each prospectus pertaining to said debentures.

10. Within thirty days after selling the debentures herein authorized to be issued and sold, Pacific Telephone 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 85287, dated December 30, 1975, in Application No. 55214 and Case No. 9832.

11. This order shall be come effective when Pacific Telephone has paid the fee prescribed by Section 1904(b) of the Public Utilities Code, which fee is $138,500.

Dated OCT 10 1979, at San Francisco, California.

President

Commissioners

PUBLIC UTILITIES COMMISSION
STATE OF CALIFORNIA
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Commissioner Claire T. Dedrick, being necessarily absent, did not participate in the disposition of this proceeding.