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Decision No. 91983 JUL 2 1980

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 $15,000,000 of its First Mortgage Bonds, Series P, through a negotiated private placement, and to execute a Eighteenth Supplemental Indenture.	Application No. 59693 (Filed May 27, 1980)

O P I N I O N

Continental Telephone Company of California (Continental), a California corporation, seeks authority to execute and deliver an Eighteenth Supplemental Indenture, and to issue and sell not exceeding $15,000,000 aggregate principal amount of its First Mortgage Bonds, Series P, through a negotiated private placement. Continental requests this authority pursuant to Sections 816 through 818 and Section 851 of the Public Utilities Code.

Notice of filing the Application was published on the Commission's Daily Calendar on May 29, 1980. The Commission has received no protests in the proceeding.

Continental furnishes local and toll telephone service in portions of Arizona, California and Nevada. It is a subsidiary of Continental Telephone Corporation, a Delaware corporation. For the year 1979, applicant's reported total operating revenues and net income amounted to $131,702,732 and $17,843,151, respectively.

Continental proposes to issue and sell $15,000,000 aggregate principal amount of its First Mortgage Bonds, Series P, under an existing indenture as heretofore amended and supplemented and to be further supplemented and amended by a proposed Eighteenth Supplemental Indenture. A form of the proposed supplemental indenture is attached to the application as Exhibit C.

It is proposed that the new bonds will be sold by private placement to various investors, at a price of 100% of the principal amount thereof, and bear interest at the rate of 13-1/2% per year. It is also proposed that the new bonds will mature on June 30, 1987, and that mandatory prorated annual sinking fund payments in the amount of $5,000,000 shall commence on June 30, 1985. It is further proposed that none of the new bonds shall be redeemable prior to June 30, 1985, and that the new bonds will be redeemable at the option of Continental any time thereafter at a redemption price equal to the par value of the new bonds.

The proceeds of the sale of the new bonds will be applied to retire short-term debt (estimated to be $25,025,000 at June 30, 1980), which Continental will have outstanding at the time such bond proceeds are received. The proceeds of such short-term obligations have been spent by the utility for capital additions and improvements. The expenses of the issue will be paid from the company's general funds and not from the proceeds received from the sale of the new bonds.

Continental's balance sheet as of March 31, 1980, attached to the application as Exhibit A, is summarized as follows:

Assets		In Thousands
Telephone Plant Less Accumulated Depreciation		$308,974
Investments		608
Current Assets		26,013
Deferred Charges		884
	Total	$336,479
Liabilities & Equity		
Common Equity		$129,936
Preferred Stock		14,645
Long-Term Debt		133,319
Current Liabilities		45,053
Deferred Credits		13,526
	Total	$336,479

Continental's capital ratios at March 31, 1980, adjusted to give effect to the sale of the new bonds and a $6,000,000 equity contribution scheduled to be made by Continental Telephone Corporation in the second quarter of 1980 are summarized as follows:

	March 31, 1980	Pro Forma
Long-Term Debt	44.68%	49.65%
Commercial Paper	7.25	.29
Preferred Stock	5.03	5.03
Common Equity	43.04	45.03
	100.00%	100.00%

Continental's plant available for the issuance of additional securities at March 31, 1980 is summarized as follows from Exhibit B to the application:

		In Thousands
Telephone Plant, Net of Depreciation		$308,731
Less: Deferred Taxes	$3,391	
Unamortized Investment Credit	7,368	10,759
Telephone Plant Available for Issuance of Securities		$297,972
Less Securities Outstanding:		
Proceeds from Common Stock	$ 12,545	
Proceeds from Preferred Stock	15,201	
Principal Amount of Long-Term Debt	134,895	162,641
Total Telephone Plant Available for Issuance of Additional Securities		$135,331

Continental requests an exemption for the proposed sale of the new bonds from the Commission's competitive bidding rule established by Decision No. 38614, dated January 15, 1946, as amended from time-to-time in Case No. 4761. The utility's reasons for requesting an exemption are set forth in its application as follows:

(a) The new bonds cannot be sold by means of a negotiated private placement unless the exemption is granted. A private placement is considerably less expensive than a public offering of debt securities, since the cost of registration under the Securities Act of 1933 is avoided and the legal fees and printing costs are lower. In addition, the fee paid to an agent for arranging a private placement is substantially less than the underwriting discounts required to consummate a public offering. Furthermore, Continental has historically obtained long-term debt through the private placement market at more favorable interest rates than it or comparably rated companies have in the competitive market.

(b) Continental believes that the interest rate on this transaction represented the most attractive rate available at the time it was negotiated. This conclusion is based on market factors as they existed on and immediately prior to April 24, 1980 (the date on which the commitment for the new bonds was made), in-house investigation of all information available to applicant on that date, and the recommendation of E. F. Hutton & Company, Inc., applicant's agent, that the transaction was the best available and should be accepted. The summary of utility bond offerings between April 8 and April 24, 1980, attached to the application as Exhibit D, shows that, on April 24, 1980 (the date on which the proposed purchaser committed to buy the new bonds), the interest rate on the new bonds was at least as favorable as that which Continental could have expected to obtain in a competitive bid on that date. The utility believes that had its issue been offered on a competitive bid basis, the loss of savings associated with this private placement as well as increased administrative costs in the form of filing fees, printing costs, attorney's fees and underwriting discounts would have resulted in a cost to the company of at least 13.87% or 13.96%.

(c) Continental expects its bank line of credit to be exhausted in July 1980. The company's short-term debt transactions are backed by a $27,000,000 bank line of credit. Without the infusion of long-term debt, short-term obligations could reach the $29,000,000 level by mid-July. A private placement will permit accelerated delivery arrangements which will allow the utility to partially retire its short-term debt as expeditiously as possible and in a time frame that is compatible with the exhaustion of the existing line of credit.

Based on the foregoing, Continental has concluded that it is selling the new bonds at a cost as low, if not lower, than would prevail if the new bonds had been sold at competitve bidding. Based on such belief, the utility states that it would be in the public interest to exempt the sale of new bonds from the competitive bidding requirements.

Exhibit B to the application shows Continental's estimated construction expenditures for 1980 and 1981 as $56,538,000 and $66,217,000, respectively. The Revenue Requirements Division has reviewed the application and has concluded that the proposed financing is necessary to implement the company's construction program. The Division reserves the right, however, to reconsider the reasonableness of any construction expenditures in future rate proceedings.

The Revenue Requirements Division has also reviewed Continental's allegation that the interest rate of 13-1/2% for the new bonds represented a rate which was as low as or lower than the rate the company could have obtained in any public offering at the time the rate was negotiated (April 24, 1980). The Division agrees that the 13-1/2% interest rate was reasonable at that time and in fact was the lowest rate obtained by any comparably rated utility during the period from April 8 to April 24, 1980.

Findings of Fact

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

2. The proposed First Mortgage Bonds would be for proper purposes.

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

4. The interest rate of 13-1/2% for the proposed First Mortgage Bonds is the lowest rate Continental could have obtained on April 24, 1980.

5. The proposed five-year restricted redemption provision for the First Mortgage Bonds is reasonable.

6. The money, property or labor to be procured or paid for by the issuance and sale of the First Mortgage Bonds, herein authorized, is reasonably required for the purposes specified herein, which purposes are not, in whole or in part, reasonably chargeable to operating expenses or to income.

7. The sale of the proposed bonds should not be required to be through competitive bidding.

8. The proposed Supplemental Indenture 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 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.

A.59693 RR/lq

ORDER

IT IS ORDERED that:

1. The sale by Continental Telephone Company of California of not exceeding $15,000,000 aggregate principal amount of its First Mortgage Bonds, Series P, is hereby exempted from the Commission's competitive bidding rule set forth in Decision No. 38614, dated January 15, 1946, as amended, in Case No. 4761.

2. Continental Telephone Company of California may execute and deliver an Eighteenth Supplemental Indenture in substantially the same form as Exhibit C attached to the application.

3. Continental Telephone Company of California may issue and sell not exceeding $15,000,000 aggregate principal amount of its First Mortgage Bonds, Series P, on terms and conditions described in the application.

4. Continental Telephone Company of California shall apply the proceeds from the sale of said bonds to the purposes set forth in the application.

5. Continental Telephone Company of California shall file with the Commission a report, or reports, as required by General Order No. 24-B, which order, insofar as applicable, is hereby made a part of this order.

6. This order shall become effective when Continental Telephone Company of California has paid the fee prescribed by Section 1904(b) of the Public Utilities Code, which fee is $13,500.

Dated JUL 2 1980, at San Francisco, California.

John E. Bryson
President

Vernon L. Sturgeon

Claire T. Dedrick

Commissioners

I dissent and will file a written statement.
Richard D. Gravelle

I dissent
Leonard M. Grimes

PUBLIC UTILITIES COMMISSION
STATE OF CALIFORNIA
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JUL 2 1980
13,500.-
By

RICHARD D. GRAVELLE, Commissioner
LEONARD M. GRIMES, Commissioner

We dissent.

Once again the Commission is placed in the posture of having to consider, and authorize or reject, a financing agreement negotiated long before its submittal for our consideration. The agreement we are asked to approve was negotiated on April 24, 1980, 33 days before the application was filed and 65 days prior to our first opportunity to authorize or reject it. In the volatile money market with which we have been recently confronted, and which remains with us today, it is unrealistic to ask us to ignore changes in market conditions which have occurred since this agreement was reached. The Commission is an indispensable party to all utility financing agreements. No such agreement can be lawfully negotiated without approval of the Commission. Recognizing our responsibility as public guardian, we cannot in good conscience approve, on July 2, a financial agreement negotiated on April 24, when prevailing interest rates have declined significantly in the interim.

We face a question of basic fairness that, in our opinion, can be resolved by a procedural modification. It is manifestly clear, from reference to Articles 5 and 6 of Part I of the Public Utilities Code, particularly Sections 816, 818, 830 and 851, that the Legislature contemplates <u>prior</u> action by the Commission before the financial transactions encompassed by those sections become operable. We are warned that if the Commission interferes with a negotiated transaction, because market conditions have changed to the detriment of the ratepayer and the benefit of the creditor, a valuable financing source for our regulated utilities will be eliminated because the financial community that participates in negotiated transactions, including private placements, will be unable to rely upon the terms of negotiated agreements they have reached in good faith with the utility based upon market conditions at the time of agreement. We do not believe, however, that we as regulators properly perform our regulatory function if we blindly ignore changes in market conditions which occur prior to our consideration of these financing agreements. We believe it is our obligation, intended by the Legislature and fully understood by the utilities and financial community, to act in the best interest of the public in full recognition of all relevant considerations. Our consideration cannot be limited solely to conditions prevailing on the date the agreement was negotiated.

To solve this problem, we suggest that the Commission no longer entertain applications that present an agreement complete except for Commission authorization. We should require the applicant utility to establish, by application to us, their need for and contemplated use of funds to be derived from the financial transaction; the time, limited to 90 days after the application, within which they contemplate completion of the transaction; their best estimate of the cost and general terms of a proposed negotiated agreement; and their assessment whether a competitive or negotiated transaction would result in the lowest cost to the ratepayer. After Commission action authorizing the utility to proceed and up to the execution of an agreement between lender and utility, all parties would be aware that any of them, including the Commission, could take action that would delay or terminate the proposed financing but, once the agreement was reached by the lender and the utility without prior Commission interference, they would know they had a firm and binding contract, subject only to Commission review for reasonableness in subsequent utility ratemaking proceedings, as are all utility contractual activities.

The benefit of such a procedural change should be obvious. The Commission would be able to meet its regulatory obligations confident in the knowledge that doing so would not inhibit either negotiated or competitive bidding transactions. The utility and the financial community would have maximum flexibility and the ratepaying public would benefit from all the foregoing.

Had the Commission authorized $15 million of financing for Continental in February or March of 1980, and had the precise agreement before us today been subsequently negotiated for execution on April 24, 1980, we would have had no objection to the agreement. It is the procedure employed and the knowledge that interest rates have declined significantly, a fact which cannot now be ignored, that have given rise to this dissent and the procedural change we have recommended. If this recommendation has faults that we have not considered, we welcome comment so that a better way, one that complies with our statutory obligation without jeopardizing the utilities' ability to finance, may be found.

RICHARD D. GRAVELLE, Commissioner

LEONARD M. GRIMES, Commissioner

San Francisco, California
July 2, 1980