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Decision No. 92582 JAN 6 1981

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 aggregate principal amount of Debentures and/or Notes and to execute and deliver an Indenture or Indentures; and for an exemption of such proposed issue or issues of Debentures and/or Notes from the requirements of the Competitive Bidding Rule.

Application No. 60102
(Filed November 21, 1980)

OPINION

The Pacific Telephone and Telegraph Company (Pacific) requests authority, pursuant to Sections 816 through 818 of the Public Utilities Code, for the following:

(a) To issue and sell either by competitive bidding or by negotiation not to exceed $300,000,000 aggregate principal amount of debentures and/or notes (debt securities) having a term or terms each not exceeding forty years and

(b) to execute and deliver an indenture or indentures.

Notice of the filing of the application was published on the Commission's Daily Calendar of November 25, 1980. The Commission has received no protests in this proceeding.

Pacific, a California corporation, is sole owner of Bell Telephone Company of Nevada and a subsidiary of the American Telephone and Telegraph Company which owns 89% of Pacific's common shares. Pacific is a public utility telephone company engaged in the business of providing local and long-distance telephone service in the State of California. Pacific's system is comprised of local and long-distance telephone lines and exchange, buildings, rights-of-way, franchises, and equipment.

During Calendar Year 1979, Pacific reported total operating revenues of $4,876,956,868 and net income of $236,189,445. For the first nine months of 1980, Pacific reports in its Consolidated Income Statement shown as part of Exhibit A attached to the application that it generated total operating revenues of $4,294,200,000 and net income of $279,200,000.

Pacific's capital ratios as recorded on September 30, 1980, and adjusted as of February 28, 1981, to give pro forma effect to (a) the proposed sale of $300,000,000 aggregate principal amount of debt securities on or about February 3, 1981; (b) the receipt in January of proceeds of about $301,000,000 related to the January 1981 common stock issue;[1/] and (c) the sale on October 28, 1980, of $150,000,000 of Forty Year 15% Debentures, due November 1, 2020, and of $150,000,000 of Ten Year 13-5/8% Notes due November 1, 1990,[2/] are as follows:

	Recorded	Pro Forma
Long-Term Debt	51.6%	53.8%
Short-Term Debt	6.4	4.1
Total Debt	58.0	57.9
Preferred Stock	5.9	5.6
Common Equity	36.1	36.5
Total	100.0%	100.0%

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's extremely high debt ratio which on a pro forma basis will approximate 58%. We believe that a significant amount of additional equity capital is necessary to balance Pacific's capital structure, and should be given primary attention in future financing plans of Pacific.

1/ Decision No. 92449, dated December 2, 1980, in Application No. 60068.

2/ Decision No. 92190, dated September 3, 1980, in Application No. 59839.

The purpose of the proposed financing is to reimburse Pacific's treasury for moneys actually expended for capital purposes from income and from other treasury funds of Pacific and its subsidiary. Such expenditures amounted to a cumulative total of $3,345,915,534 as of September 30, 1980.

Pacific has a continuing need for capital for the acquisition of property and for the construction, completion, extension and improvement of Pacific's facilities and its subsidiary used in both intrastate and interstate operations. In particular, Pacific has need at this time to obtain funds to enable it to retire in part its short-term borrowings. Short-term borrowings have been increasing steadily and are expected to continue to do so. Such borrowings are expected to be about $765 million by the end of February 1981, in the absence of the proposed financing.

Pacific's estimates for the year 1981 indicate the need for $3,026,000,000 gross construction outlays related to customer growth and movement, and for plant modernization and replacement as follows:

Item	
Customer Growth	$1,790,000,000
Customer Movement	577,000,000
Plant Modernization	473,000,000
Plant Replacement	186,000,000
Total	$3,026,000,000

Pacific anticipates that the proceeds from the sale would be available on or about February 12, 1981. Pacific 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. When the treasury has been reimbursed, Pacific intends to apply an equivalent amount to repayment of its then outstanding short-term borrowings.

The staff of the Commission's Revenue Requirements Division has reviewed Pacific's application and its 1981 construction program and concludes that the estimated construction expenditures are reasonable. The Division reserves the right, however, to reconsider the reasonableness of an construction expenditure in future rate proceedings.

The proposed debt securities are to be issued under an indenture or indentures between Pacific and The Bank of California, National Association, as Trustee. In previous issues of Pacific's debt securities, the form of indenture provided that the securities could not be redeemed until on or after a date five years from the date of the indenture. Pacific expects that a similar provision will be employed for the proposed issue(s) of debt securities. However, market conditions and Pacific's financial situation on or about the sale date may require some alternative redemption provision. Thus, whether the debt securities will be nonredeemable or redeemable, and, if redeemable, the terms and conditions of such redemption will be determined by the Chairman of the Board of Directors, the President, the Chief Financial Officer, or the Treasurer of Pacific.

Depending upon market conditions expected to prevail at the time of sale, Pacific proposes to sell the debt securities either by competitive bidding or by means of a negotiated underwriting by a nationwide group or groups of investment banking firms. This determination would be made in early January 1981. If negotiation is chosen, the underwriters would purchase all of the debt securities, in accordance with a purchase agreement or agreements substantially in the form attached to the application as part of Exhibit E. Although present market conditions are such that Pacific believes it would be beneficial to sell the debt securities on a negotiated basis, Pacific desires alternative authority to sell them pursuant to competitive bidding in the event of substantially improved market conditions.

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

In Decision No. 91984, dated July 2, 1980, for the San Diego Gas & Electric Company, Application No. 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 will not serve as compelling reasons, individually or collectively, for granting an exemption from the competitive bidding rule.

We also stated in Decision No. 91984, that the decision was not to be construed as a blanket prohibition of negotiated sales. The decision merely clarified our requirement of a "compelling showing" to gain an exemption constitutes a very high standard of proof. Such a standard requires that utilities, in most instances, proceed initially on a competitive bid basis with the ability to return to the Commission for an exemption if the bids are unacceptable.

We gave notice to utilities who file applications requesting exemption from our competitive bidding rule that they can expect to have the request for a competitive bidding exemption denied, with the application approved on the condition that competitive bidding will be used, and that we may do this absent public hearings. We also stated that if utilities attempt a competitive sale and do not consummate it because the terms are unfavorable, they may petition for modification of the decision authorizing the sale and seek to demonstrate why competitive bidding is not in the public interest.

We do not believe that we have yet reached an optimal solution to this complex problem. We intend to explore the advantages and disadvantages of revisions in the competitive bidding rule to respond to changes in the financial market place.

In the present case, we are frankly uncertain whether under current volatile market conditions, unfavorable to the issuer of corporate debt, strict adherence to the competitive bidding rule would prove beneficial. Consequently, for this application only we will authorize Pacific to proceed on either a competitive bid or a negotiated bid basis, according to Pacific's estimation of where the most favorable opportunity lies. We place Pacific on notice, however, that if it chooses to pursue the path of a negotiated bid, we will expect our staff to give exceptionally close and critical scrutiny in the appropriate rate proceeding to the reasonableness of the financing and debt costs associated with this securities issue. We make clear our intention to give such scrutiny to the reasonableness of such costs ourselves. We will require Pacific to provide us with a showing 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 the proposed bonds.

Findings of Fact

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

2. The proposed sale of debt securities is for proper purposes.

3. The utility has need for external funds for the purposes set forth in this proceeding.

4. The terms and conditions of the proposed issuance and sale of debt securities are just and reasonable and in the public interest.

5. It is uncertain whether, under current volatile market conditions, strict adherence to the competitive bidding rule would be beneficial.

6. Pacific should be authorized to proceed on either a competitive bid or a negotiated bid basis. If Pacific pursues a negotiated bid, close scrutiny of the resultant costs should be given in the appropriate rate proceeding.

7. Since debt securities are unsecured, no California property would become encumbered thereby.

8. The money, property or labor to be procured or paid for by the issuance and sale of the debt securities 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.

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 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 May 31, 1981, not exceeding $300,000,000 aggregate principal amount of debt securities in accordance with the application and the terms and provisions of a purchase agreement or agreements substantially in the form filed as a part of Exhibit E to the application, with a term or terms each not to exceed forty years, with a maturity date or dates related to the actual sale date and with redemption features appropriate to market conditions existing at about that time.

2. The Pacific Telephone and Telegraph Company's request for an exemption of the proposed issue and sale of debt securities from the Commission's competitive bidding rule set forth in Decision No. 38614, dated January 15, 1946, as amended, is granted on the condition that the company may proceed on either a competitive bid or a negotiated bid basis.

3. The Pacific Telephone and Telegraph Company is authorized to execute and deliver an indenture or indentures 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 debt securities, except that the redemption provision may be modified or deleted as provided in the application.

4. Within thirty days after the issuance and sale of the debt securities herein authorized, The Pacific Telephone and Telegraph Company shall file with the Commission a report showing that the resulting interest rate and cost of money to the company were the most advantageous to the company and its ratepayers.

5. 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 debt securities for the purposes stated in the application (accrued interest may be used for general corporate purposes).

6. The Pacific Telephone and Telegraph Company shall file with the Commission a written report showing for each bid received, the name of the bidders, the price, the interest rate, and the cost of money to it based upon the price and interest rate.

7. As soon as available, The Pacific Telephone and Telegraph Company shall file with the Commission three copies of each prospectus pertaining to the debt securities.

8. Within thirty days after selling the debt securities 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 debt securities issued and sold and the use of the proceeds ther from substantially in the format set forth in Appendix C of Decision No. 85287, dated December 30, 1975, in Application No. 55214 and Case No. 983?.

9. 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 JAN 6 1981, at San Francisco, California.

John E. Bryson
President
Richard D. Gravelle
Leonard M. Grimes

PUBLIC UTILITIES COMMISSION
STATE OF CALIFORNIA
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156,000.
By [signature]