RR/mcm

Decision No. 92878 APR 7 1981

ORIGINAL

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 $35,000,000 of its First Mortgage Bonds, Series R, through a negotiated private placement, and to execute a Twentieth Supplemental Indenture.	Application 60262 (Filed February 13, 1981)

O P I N I O N

Continental Telephone Company of California (Continental) requests authority, pursuant to Sections 816 through 818 and 851 of the Public Utilities Code, for the following:

1. To issue and sell through negotiated private placement or competitive offering its First Mortgage Bonds, Series R, (New Bonds) in an aggregate principal amount not to exceed $35,000,000;

2. To execute and deliver a Twentieth Supplemental Indenture.

Notice of the filing of the Application appeared on the Commission's Daily Calendar of Febraury 19, 1981. No protests have been received.

Continental is a California corporation (a subsidiary of Continental Telephone Corporation, a Delaware corporation) primarily engaged in the business of furnishing local and toll telephone service in portions of Arizona, California and Nevada. For the calendar year 1980, Continental reported total operating revenue of $140,037,157 and net income of $18,520,152.

Continental proposes to issue and sell $35,000,000 aggregate principal amount of its New Bonds under an existing indenture as heretofore amended and supplemented and to be further amended and supplemented by a proposed Twentieth Supplemental Indenture. The proposed supplemental indenture is to be substantially in the same form as the form of the Eighteenth Supplemental Indenture attached as Exhibit C to Application (A.) 59693, dated May 27, 1980, and authorized by Decision (D.) 91983, dated July 2, 1980, with such changes as are required to reflect the terms of the New Bonds.

Continental, with the assistance of one or more investment bankers, intends to negotiate for the private placement of the New Bonds for issuance and delivery in late 1981 or early 1982, close to the time at which Continental's Series K Bonds must be retired. In addition, Continental requests alternative authorization to sell the New Bonds in a competitive offering, should its view of market conditions change prior to a commitment for a sale of the New Bonds. In the event of a private placement, the terms of the New Bonds will be fixed at the time of negotiation and will be embodied in a purchase agreement in a form substantially similar to Exhibit E to A.59693, which Continental expects to execute within a reasonable time after negotiations are complete, even if delivery of the New Bonds is to be delayed for several months.

Continental states in the Application that it believes, in addition to authorization of a competitive offering, an exemption from the competitive bidding rule should be granted in order to permit a negotiated private placement of the New Bonds. This would allow Continental reasonable flexibility in planning for the New Bond financing and the retirement of its Series K Bonds. Continental states that it believes it can sell the New Bonds at as low, if not lower, a cost than would prevail if the New Bonds were sold at competitive bidding and that this will result in the lowest cost to its ratepayers. Based on such belief, Continental states that it would be in the public interest to exempt the sale of New Bonds from the Commission's competitive bidding requirements.

The proceeds of the sale of the New Bonds will be applied to retire $25,000,000 of Continental's Series K Bonds at maturity on January 15, 1982 and to retire $10,000,000 of short-term indebtedness incurred to partially and temporarily finance Continental's construction program. Continental estimates that its indebtedness to holders of short-term obligations will exceed $10,000,000 at the time the New Bonds are issued. All proceeds of such Series K Bonds and short-term obligations will have been spent by Continental for capital additions and improvements. The expenses of the issue will be paid from Continental's general funds and not from the proceeds received from the sale of the New Bonds.

Continental's Balance Sheet as of December 31, 1980, attached to the Application as Exhibit A, is summarized as follows:

Assets	Amount
Total Telephone Plant Less Accumulated Depreciation	$334,904,398
Investments	1,196,709
Current Assets	21,008,286
Deferred Charges	961,110
Total	$358,070,503
Liabilities and Other Credits	
Common Equity	$141,073,540
Preferred Stock	14,645,100
Long-Term Debt	146,764,188
Current Liabilities	40,144,348
Deferred Credits	15,443,327
Total	$358,070,503

Continental's capital ratios at December 31, 1980 and adjusted on a pro forma basis to give effect to the sale of the New Bonds are summarized from Exhibit B attached to the Application as follows:

	December 31, 1980	Pro Forma
Long-Term Debt	48.79%	50.40%
Preferred Stock	4.82	4.02
Common Equity	46.39	45.58
Total	100.00%	100.00%

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

	Detail	Amount
Telephone Plant, Net of Depreciation		$334,705,874
Less: Deferred Taxes	$3,852,180	
Unamortized Investment Credit	9,444,124	13,296,304
Telephone Plant Available for Issuance of Securities		$321,409,570
Less Securities Outstanding:		
Proceeds from Common Stock	$ 12,545,115	
Proceeds from Preferred Stock	14,645,100	
Principal Amount of Long-Term Debt	148,352,492	175,542,707
Total Telephone Plant Available for Issuance of Additional Securities		$145,866,863

Continental requests an exemption for the proposed sale of the New Bonds from the Commission's competitive bidding rule established by D.38614, dated January 15, 1946, as amended from time-to-time in Case 4761. Continental's reasons for this request were set forth in its letters to the Commission's staff dated March 6 and 18, 1981, as follows:

a. A private placement is considerably less expensive than a public offering. Private placement avoids the costs of registration under the Securities Act of 1933, thus avoiding legal fees. Printing costs are lower. Also, fees paid to agents are lower than for public offerings.

b. Analysis of Continental's underwriting costs shows that competitive bidding costs are more than three times greater than for private placements. Privately placed issues were compared to those competitively placed. The comparison is based on the weighted average underwriting discounts of privately vs. competitively placed issues. A co-variance analysis of the weighted averages of underwiting discounts demonstrated that the greater magnitude of principal amounts of competitively placed issues was not the cause of the higher underwriting costs.

c. The historic weighted average of underwriting discounts for privately placed issues is .4297% and for competitively placed issues is 1.2437%. For a $35 million issue, at a market rate of 14.5%, the differential effective yield between a privately and competitively placed issue would be approximately 12 basis points ($285,000).

d. Other costs in addition to underwriting of a competitive public offering are printing fees, accountant's fees, legal fees, and filing fees. These extra costs (from $154,000 to $294,000) would add an additional 6 to 12 basis points to the differential effective yield.

e. The total differential yield between privately placed debt and competitively placed debt would be 18 to 24 basis points (from $439,000 to $579,000).

The staff of the Revenue Requirements Division has reviewed the foregoing reasons and concurs with Continental that offering its debt securities by means of a public sale, such as a negotiated or competitive offering, would be more costly than a sale by private placement. The staff believes and concludes that a private placement of the proposed New Bonds is less costly because of reduced filing fees, printing costs, accountant's fees, attorney's fees and underwriting fees.

In D.91984, dated July 2, 1980, for San Diego Gas & Electric Company's A.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 group will not serve as compelling reasons, individually or collectively, for granting an exemption from the competitive bidding rule.

Because Continental intends to sell the proposed New Bonds by private placement on terms which will be negotiated after the issuance of this decision and because of the staff's conclusion and belief that the New Bonds will be sold at a cost as low, if not lower than would prevail if the New Bonds were to be sold at competitive bidding, we are of the opinion that applying the Commission's competitive bidding requirements and conditions set forth in D.91984 in this proceeding would not be in the best interests of Continental or its ratepayers. The rule would not operate to ensure that Continental's sale of the New Bonds would be at the most favorable cost of money. However, in order not to preclude the competitive bid option, we will also grant Continental the authority to issue the proposed New Bonds by means of a competitive offering.

Continental is put on notice that in its next general rate proceeding before the Commission, the reasonableness of the resulting interest rate and cost of money to the company will be closely scrutinized and may result in a disallowance of the interest expense if it is determined that the cost of money incurred was not the most prudent.

Exhibit B to the Application shows Continental's estimated net construction expenditures for calendar year 1981 will approximate $61,090,000. Exhibit B sets forth in detail the company's construction program estimated as follows:

	1981 (Dollars in Thousands)
Construction and Plant Expenditures (Including Cost of Removal:)	
Station Apparatus and Connections	$ 5,169 1/
Other Operations (Key Systems, Special Systems, Furniture and Work Equipment)	5,381
Outside Plant	21,122
Central Office Equipment	18,009
Land and Buildings	1,657
Other	3,362
Overheads	8,534
Total Construction and Plant Expenditures	$63,234
Salvage Value	(2,144)
Net Construction and Plant Expenditures	$61,090

1/ Assumes station connections will be expensed in 1981.

The Revenue Requirements Division and the Communications Division have reviewed the Application and have concluded that the proposed financing is necessary to implement the company's construction program. The Divisions reserve the right, however, to reconsider the reasonableness of any construction expenditures in future rate proceedings.

Findings of Fact

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

2. The proposed New Bonds would be for proper purposes.

3. Continental has need for external funds for the purposes set forth in the Application.

4. Continental believes it will be able to obtain an effective interest rate on its New Bonds through negotiated private placement for delayed delivery in late 1981 or early 1982, as low as or lower than it could obtain from a competitive bid public offering of such bonds and should be authorized to proceed in the manner described in the Application.

5. Continental should be authorized to issue and sell up to $35,000,000 principal amount of New Bonds, either through private placement or by competitive bidding upon terms and at a time which Continental determines to be the most advantageous to it and its ratepayers.

6. The money, property or labor to be procured or paid for by the issuance and sale of the New 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.

ORDER

IT IS ORDERED that:

1. Continental Telephone Company of California, on or after the effective date hereof and on or before December 31, 1981, may enter into a contract or contracts for issuance, sale and delivery of its First Mortgage Bonds, Series R, in an aggregate principal amount not to exceed $35,000,000, for future delivery in accordance with the terms and conditions to be negotiated as described in the Application. This sale is hereby exempted from the Commission's competitive bidding rule; alternatively, Continental Telephone Company of California may issue, sell and deliver these bonds by means of a competitive offering.

2. Continental Telephone Company of California may execute and deliver a Twentieth Supplemental Indenture in substantially the same form as that attached to A.59693, dated May 27, 1980, as Exhibit C with such changes therein as are required to reflect the terms of the First Mortgage Bonds, Series R.

3. Continental Telephone Company of California shall apply the proceeds from the sale of its First Mortgage Bonds, Series R, to the purposes set forth in the Application.

4. Promptly after executing a contract for the sale of its First Mortgage Bonds, Series R, Continental Telephone Company of California shall file a copy of the contract and a written report with the Commission, showing the interest rate and the cost of money to Continental based on such price and interest rate.

5. As soon as available, Continental Telephone Company of California shall file a conformed copy of the purchase agreement for the First Mortgage Bonds, Series R, and the definite form of the Twentieth Supplemental Indenture.

6. If the First Mortgage Bonds, Series R, are sold by competitive bidding, as soon as available, Continental Telephone Company of California shall file with the Commission three copies of its final prospectus pertaining to these bonds.

7. Continental Telephone Company of California shall file the reports required by General Order No. 24.

8. 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 $11,000,

A.60262 RR/mcm

after taking credit for the retirement of $25,000,000 principal amount of 10% First Mortgage Bonds, Series K, due January 15, 1982.

Dated APR 7 1981, at San Francisco, California.

John E. Bryson

President

Richard D. Gravelle

Leonard M. Grimes, Jr.

Victor Calvo

Priscilla C. Grew

Commissioners

PUBLIC UTILITIES COMMISSION
STATE OF CALIFORNIA
PAID
APR 10 1981
By