

Decision 93052 MAY 19 1981

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of THE PACIFIC )  
 TELEPHONE AND TELEGRAPH COMPANY, )  
 to issue on a negotiated basis a )  
 promissory note or notes in an )  
 aggregate principal amount not to )  
 exceed \$300,000,000; and for an )  
 exemption of such proposed issue )  
 or issues from the requirements )  
 of the Competitive Bidding Rule. )

Application 60450  
(Filed April 15, 1981)

O P I N I O N

The Pacific Telephone and Telegraph Company (Pacific) requests authority, under Sections 816 through 818 of the Public Utilities Code, to enter into an agreement or agreements to issue and sell on a negotiated basis by private placement an unsecured promissory note or notes (Term Notes) in an aggregate principal amount of up to \$300,000,000, exempt from the Commission's competitive bidding rule and with a term or terms of not to exceed 15 years.

Notice of the filing of the application appeared on the Commission's Daily Calendar of April 17, 1981. No protests have been received.

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.

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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 exchanges, buildings, rights-of-way, franchises and equipment.

For calendar year 1980, Pacific reports total consolidated operating revenues of \$5,782,300,000 and net income of \$365,700,000. For the two months ended February 28, 1981, Pacific reports in its Consolidated Income Statement shown as part of Exhibit A attached to the application that it generated total operating revenues of \$1,016,340,000 and net income of \$54,988,000.

Pacific proposes to enter into an agreement or agreements to issue and sell on a negotiated basis by private placement Term Notes in the aggregate principal amount of up to \$300,000,000 having a term or terms not to exceed 15 years. The number of Term Notes, the exact aggregate amount, the form(s) and character, and the terms and conditions, such as maturity, the interest rate or rates, and any special features pertaining to redemption, shall be determined by Pacific's chairman of the board of directors, president, executive vice president, and chief financial officer or treasurer.

Pacific anticipates that the Term Notes will be completely placed no later than August 31, 1981. Pacific expects to apply the proceeds (other than accrued interest which would be used for general

corporate purposes) toward reimbursement of its treasury. When the treasury has been reimbursed, Pacific intends to apply an equivalent amount to repayment of its then outstanding short-term borrowings which are expected to be about \$950 million by end of June 1981 in the absence of the proposed financing.

Pacific further states that due to the nature of the transactions involved in privately placing note issues, it would not be appropriate for this Commission to apply its competitive bidding rule. Pacific also points out that the proposed financing does not require any Security Exchange Commission (SEC) registration, prospectus or listing on the exchanges. A public debt offering involves accountants' fees, SEC filing fees, and substantially higher printing costs. A public offering would entail underwriting costs which are normally greater than private placement agent fees. Pacific, therefore, states its belief that the private placement of debt, as proposed, will be accomplished at a cost as low, if not lower, than would prevail if securities were sold at competitive bidding through a public offering.

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

In Decision (D.) 91984, dated July 2, 1980, for San Diego Gas & Electric Company's Application (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 Pacific intends to sell the proposed Term Notes 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 Term Notes will be sold at a cost as low, if not lower than would prevail if the Term Notes 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 Pacific or its ratepayers. The rule would not operate to ensure that Pacific's sale of the Term Notes would be at the most favorable cost of money. However, in order not to preclude the competitive bid option, we will also grant Pacific the authority to issue the proposed Term Notes by means of a competitive offering.

Pacific 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.

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. These expenditures amounted to a cumulative total of \$3,375,144,772 as of February 28, 1981.

Pacific's capital ratios as recorded on February 28, 1981, and as adjusted to June 30, 1981, to give pro forma effect to:

1. The proposed placement of up to \$300,000,000 aggregate principal amount of Term Notes beginning in June 1981, and
2. The sale on March 25 1981 of \$150,000,000 of Forty Year 16-1/8% Debentures due April 1, 2021, and of \$150,000,000 of Ten Year 15% Notes due April 1, 1991, (D.92582, dated January 6, 1981, in A.60102.)

and are as follows:

	<u>Recorded</u>	<u>Pro Forma</u>
Long-Term Debt	51.9%	53.9%
Short-Term Debt	5.1	5.5
Total Debt	<u>57.0</u>	<u>59.4</u>
Preferred Stock	5.7	5.4
Common Equity	37.3	35.2
Total	<u>100.0%</u>	<u>100.0%</u>

In D.92582, dated January 6, 1981, in A.60102, we 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 were deeply concerned in that proceeding with Pacific's extremely high debt ratio which on a pro forma basis approached 58%. It was our opinion that a significant amount of additional equity capital was necessary to balance Pacific's capital structure and we indicated that the issuance of equity capital be given primary attention in future financing plans of Pacific.

In the present application this debt ratio on a pro forma basis approximates 59.5%, which is extremely high for Pacific. The common equity ratio would deteriorate to about 35.2%. Pacific, however, plans to seek authority to issue 25,000,000 shares of common stock in July 1981 (for possible sale in September) which is expected to produce net proceeds of \$375,000,000. Pacific also expects to issue 1,300,000 shares of common stock under its Employee Stock Ownership Plan (ESOP) which is expected to produce net proceeds in 1981 of \$19,500,000. Pacific estimates that after the issuance of additional common equity its debt ratio would approximate 58%, a slight improvement over the pro forma debt ratio of 59.5% estimated in this proceeding. We caution Pacific that it should strive to increase its common equity ratio to 38% and that it should strive to achieve

✓ this ratio in 1982. ~~If this goal is not obtained during 1982, Pacific~~  
SS ~~would place itself in jeopardy of not having future debt offerings~~  
~~approved by this Commission.~~

Pacific's estimates for the year 1981 indicate the need for \$2,935,000,000 gross construction outlays related to customer growth and movement and for plant modernization and replacement as follows:

<u>Purpose</u>	<u>Amount</u>
Customer Growth	\$1,724,000,000
Customer Movement	549,000,000
Plant Modernization	501,000,000
Plant Replacement	161,000,000
	<u>\$2,935,000,000</u>

The staff of the Commission's Revenue Requirements Division has reviewed Pacific's application and its 1981 construction program. In Pacific's current rate proceeding (A.59849), there is a \$108,500,000 difference between the Division's and the Company's estimates of 1981 construction expenditures. Such a difference would not affect Pacific's financing plans at this time. Pacific, as previously indicated in this opinion, intends to use the proceeds from the sale of the Term Notes to reimburse the treasury and to repay short-term borrowings which are expected to be about \$950,000,000 by the end of June, 1981 (Exhibit B of the application). The Division reserves the right, however, to reconsider the reasonableness of any construction expenditures in future rate proceedings.

Findings of Fact

1. Pacific, a California corporation, operates as a public telephone utility under the jurisdiction of this Commission.
2. The proposed issuance and private placement of Pacific's Term Notes are for proper purposes.
3. Pacific has need for external funds for the purposes set forth in this proceeding.
4. Pacific believes it will be able to issue and sell its Term Notes through a negotiated private placement at a cost to the company as low or lower than it could obtain from an offering by competitive bidding.
5. Pacific should be authorized to issue and sell up to \$300,000,000 of Term Notes either through private placement or by competitive bidding upon terms and at a time which Pacific determines to be most advantageous to it and its ratepayers.
6. The debt securities are unsecured since no California property would become encumbered thereby.
7. The money, property or labor to be procured or paid for by the debt, 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.
8. There is no known opposition to the application 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 authority, 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.

The following order should be effective on the date of signature to enable Pacific to expeditiously issue its Term Notes.

O R D E R

IT IS ORDERED that:

1. The Pacific Telephone and Telegraph Company may enter into an Agreement or Agreements and issue on a negotiated basis by private placement on or before August 31, 1981, an unsecured Promissory Note or Notes in the aggregate principal amount of up to \$300,000,000 with a term or terms each not to exceed 15 years, and with such terms and conditions, interest rate or rates and any redemption provisions or other special features as may be determined necessary or advisable in accordance with the application.

2. The proposed issuance on a negotiated basis and private placement of the debt, authorized herein, is exempted from the Commission's competitive bidding rule set forth in D.38614, dated January 15, 1946, as amended in C.4761; alternatively, The Pacific Telephone and Telegraph Company may issue, sell, and deliver these debt securities by means of a competitive offering.

3. The Pacific Telephone and Telegraph Company shall use the proceeds of the issuance and private placement of the debt securities, authorized herein, for the purposes set forth in the application.

4. As soon as available, the Pacific Telephone and Telegraph Company shall file a conformed copy of each Promissory Note and Agreements or instruments executed and delivered by it in connection with the debt securities, herein authorized.

5. Within 30 days after the proceeds from the private placement of the debt securities, herein authorized, are available, The Pacific Telephone and Telegraph Company shall file with the Commission a letter reporting the amount of the debt issued, whether privately or competitively placed and the use of the proceeds substantially in the format set forth in Appendix C of D.85287, dated December 30, 1975, in A.55214 and C.9832.

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

Dated MAY 19 1981 at San Francisco, California.

*John E. Byrne*  
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President

*Richard D. [unclear]*  
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*Samuel W. [unclear]*  
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*Priscilla C. Green*  
\_\_\_\_\_  
Commissioners

