T/KLH/ARM/WPSC

Decision 93380 AUG 4 1981

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of THE PACIFIC TELEPHONE COMPANY AND TELEGRAPH COMPANY, to issue on a negotiated basis a promissory note or notes in an aggregate principal amount not to exceed \$200,000,000; and for an exemption of such proposed issue or issues from the requirements of the Competitive Bidding Rule.	Application 60696 (Filed June 29, 1981)

OPINION

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 \$200,000,000, exempt from the Commission's competitive bidding rule and with a term or terms of not to exceed six years.

Notice of the filing of the application appeared on the Commission's Daily Calendar of July 2, 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 91% 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 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 five months ended May 31, 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 $2,598,200,000 and net income of $120,000,000.

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 $200,000,000 having a term or terms not to exceed six 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 $1,000,000,000 by end of August 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 Securities and 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 Revenue Requirements Division has reviewed the foregoing reasons and has concurred 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 Division 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 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.

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 $3,490,764,906 as of May 31, 1981.

Pacific's estimates for the year 1981 indicate the need for $2,834,000,000 gross construction outlays related to customer growth and movement and for plant modernization and replacement as follows:

Purpose	Amount
Customer Growth	$1,671,000,000
Customer Movement	518,000,000
Plant Modernization	487,000,000
Plant Replacement	$ 158,000,000
	$2,834,000,000

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 $1,000,000,000 by the end of August, 1981 (Exhibit B of the application). The Division reserves the right to reconsider the reasonableness of any construction expenditures in future rate proceedings.

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.

Pacific's capital ratios as recorded on May 31, 1981, and as adjusted to August 31, 1981, to give pro forma effect to:

1. The proposed placement of up to $200,000,000 aggregate principal amount of Term Notes beginning in August 1981 and
2. The sale on June 25, 1981 of $18,500,000 of 16% Term Notes, due June 20, 1986 and $104,750,000 of 16.25% Term Notes, due June 20, 1996. The expected sale on October 14, 1981 of $57,500,000 of 16% Term Notes, due June 10, 1986 and $29,250,000 of 16.25% Term Notes, due June 20, 1996 (D.93052, dated May 19, 1981 in A.60450)

are as follows:

	Recorded	Pro Forma
Long-Term Debt	52.8%	54.1%
Short-Term Debt	5.7	6.0
Total Debt	58.5	60.1
Preferred Stock	5.5	5.3
Common Equity	36.0	34.6
Total	100.0%	100.0%

In D.92582, dated January 6, 1981 in A.60102, we stressed the importance of utilities to maintain a balanced capital structure in order to be financially sound, to maintain financial flexibility, and to attract capital at reasonable rates. We were deeply concerned in that proceeding with Pacific's 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.

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In the present application this debt ratio on a pro forma basis approximates 60.1%, which is extremely high for Pacific. The common equity ratio would deteriorate to about 34.6%. Pacific, however, plans to seek authority to issue 25,000,000 shares of common stock in August 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%, only a very slight improvement over the pro forma debt ratio of 60.1% estimated in this proceeding. However, this is a good first step toward improvement of Pacific's capital structure.

We direct Pacific's as well as our staff's attention to the discussion of return on equity on pages 139 through 145 in D.93367 in A.59849 (Pacific's general rate case). There the Commission expresses its firm expectation that there will be a massive infusion of equity into Pacific. Pacific is directed there to submit within 60 days its plan for new debt and equity offerings over the next two years. We cannot, and do not, say now that all new debt offerings will be disapproved as inconsistent with achieving our goal of a fifty percent debt, fifty percent equity capital structure. However, we can say that this is the last debt offering which will be approved without thorough review after evidentiary hearings. Future debt offerings must be consistent with an improved capital structure or authority to issue the debt instruments will be denied. This course is necessary if this Commission is to succeed in its goal of minimizing, for the ratepayers' benefit, Pacific's debt costs in the future.

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 $200,000,000 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.

7. The money, property, or labor to be procured or paid for by the proposed debt securities is reasonably required for the purposes specified in the application.

8. There is no known opposition to the application and no reasons 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 proposed security issue is for lawful purposes and the money, property, or labor to be obtained by it are required for these purposes. Proceeds from the security issue may not be charged to operating expenses or income.

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

ORDER

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 December 31, 1981 an unsecured Promissory Note or Notes in the aggregate principal amount of up to

$200,000,000 with a term or terms each not to exceed six 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 is exempted from the Commission's competitive bidding rule set forth in D.38614, dated January 15, 1946 as amended in Case 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 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.

5. Within 30 days after the proceeds from the private placement of the debt securities 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 $106,000 fee set by Section 1904(b) of the Public Utilities Code.

Dated AUG 4 1981, at San Francisco, California.

President

Commissioners

PUBLIC UTILITIES COMMISSION
STATE OF CALIFORNIA
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By