

TELCO/RSK/KOK/DLW/RHG

Decision 08-02-026 February 28, 2008

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF  
CALIFORNIA**

In the Matter of the Application of KERMAN  
TELEPHONE COMPANY U-1012-C, for an  
Order authorizing it to issue notes in an amount  
not exceeding \$7,677,000, and to execute a related  
agreement and supplemental security  
instruments.

Application 07-10-023  
(Filed October 29, 2007)

**OPINION ON BORROWING**

**1. Summary**

This decision grants Kerman Telephone Company (KTC) the authority requested in Application (A.) 07-10-023 (Application).

KTC requests authority, pursuant to § 818 and § 851 of the California Public Utilities Code, to enter into a loan agreement with the United States of America, acting through the Rural Utilities Service (RUS), for the purpose of borrowing \$7,677,000, and to execute mortgages and security instruments.<sup>1</sup> The proceeds of the loan will be used for the improvement of facilities, and funding future projects and engineering costs.

**2. Background**

KTC is a California corporation, operating as a local exchange telephone company, under the jurisdiction of the Commission. KTC provides telephone services to a portion of Fresno County, California. The property owned by KTC consists principally of telephone facilities,

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<sup>1</sup> All statutory references are to the Public Utilities Code unless otherwise indicated.

including central office equipment, aerial and buried cable, land and buildings.

KTC's income statement for the year ended December 31, 2006, shown as part of Exhibit A to the Application, presents total operating revenues of \$10,042,493, and net income of \$1,241,448. The balance sheet, as of December 31, 2006, shown as part of Exhibit A, is summarized as follows:

<u>Assets</u>	<u>Amount</u>
Current Assets	\$ 3,339,989
Investment and Other Assets	654,304
Net Property, Plant, and Equipment	<u>15,960,193</u>
 Total Assets	 <u>\$19,954,486</u>
 <u>Liabilities &amp; Stockholders' Equity</u>	
Current Liabilities	\$ 2,394,049
Long-Term Debt	6,675,369
Deferred Income Taxes	1,930,091
Stockholders' Equity	<u>8,954,977</u>
 Total Liabilities & Stockholders' Equity	 <u>\$19,954,486</u>

### **3. Notice and Protests**

Notice of the filing of the Application appeared on the Commission's Daily Calendar of October 31, 2007. No protests have been received.

### **4. Description of Financing**

KTC has previously obtained long-term secured borrowings from the RUS (formerly the Rural Electrification Administration) and from the Rural Telephone Bank. In Decision (D.) 02-09-019, dated September 5,

2002, in A.02-06-054, the Commission authorized KTC to secure a \$6,936,700 loan from the RUS to finance the construction and upgrades of utility facilities, the acquisition and installation of new digital equipment, and the retirement of interim financing arrangements. The outstanding balance of this 2002 RUS loan is \$5.2 million, and will mature in 2016.

In this Application, KTC seeks authority to enter into a loan agreement with the RUS for \$7,677,000, to be secured by substantially all of KTC's property and will be subject to documentation substantially similar to the Loan Agreement and Restated Mortgage, Security Agreement and Financing Statement, attached as Exhibit C to the Application.<sup>2</sup> KTC indicates that the loan will be repaid by amortizing monthly installment payments, commencing two years after execution and concluding nineteen years after execution, with interest rates to be determined for each advance by reference to the Rural Electrification Act of 1936 and implementing regulations. KTC points out that such rates are essentially RUS' cost of money and consistently lower than rates available from private and commercial lenders.

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<sup>2</sup> As of December 30, 2006, KTC has total assets of \$19,954,486 which is sufficient to secure the loan authorized by D.02-09-019 and the \$7.677 million requested in this Application.

## 5. Construction Budget

KTC's 5-year construction budget, shown as Exhibit B to the Application and revised on January 8, 2008, follows:

	(Thousands of Dollars)					
	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>Total</u>
Land	0	0	0	0	0	0
Distribution						
Improvements	1,865	1,460	1,198	1,433	1,390	7,346
Miscellaneous	0	0	0	0	0	0
Contingencies	0	0	0	0	0	0
New Business	0	0	0	0	0	0
Office Equipment	50	10	85	10	10	165
Transportation Equipment	301	0	62	0	30	393
Other Equipment	384	230	355	257	270	1,496
Electric Plant	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
 Total	 <u>2,600</u>	 <u>1,700</u>	 <u>1,700</u>	 <u>1,700</u>	 <u>1,700</u>	 <u>9,400</u>

KTC intends to use the loan proceeds for improvement of facilities and funding future projects. While the construction or improvements of a company's facilities are proper uses for financing authority, we will not make a finding in this decision on the reasonableness of KTC's proposed construction program.

## 6. Cash Requirements Forecast

KTC's revised 5-year cash requirements forecast, as shown in Exhibit B to the Application, as amended on January 8, 2008, is summarized as follows:

	(Thousands of Dollars)					
	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>Total</u>
Funds for construction	2,600	1,700	1,700	1,700	1,700	9,400
Bonds, Notes retired <sup>3</sup>	624	731	819	843	917	3,934
Preferred Shares retired	0	0	0	0	0	0
Refunds of advances	0	0	0	0	0	0
Dividends	500	500	500	500	500	2,500
Short-term debt repaid	<u>1,000</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>1,000</u>
 Total Funds Needed	 4,724	 2,931	 3,019	 3,043	 3,117	 16,834
 Less: Estimated Cash Available from Internal Sources <sup>4</sup>	   <u>1,600</u>	   <u>1,600</u>	   <u>1,600</u>	   <u>1,600</u>	   <u>1,600</u>	   <u>8,000</u>
 Additional New Funds Required from Outside Sources	   <u>3,124</u>	   <u>1,331</u>	   <u>1,419</u>	   <u>1,443</u>	   <u>1,517</u>	   <u>8,834</u>

KTC points out in the Application that funds generated from revenues will be used principally for servicing debt and payment of dividends. It appears that KTC needs the financing authority requested in the Application to finance capital improvements. The requested authority in this filing would help meet the majority of KTC's construction program for 2008 to 2012.<sup>5</sup>

<sup>3</sup> The estimated amount consists of current maturities of mortgage notes. In 2006, current maturities of mortgage notes totaled \$617,698.

<sup>4</sup> The estimated amount is derived from the intrastate net income of \$1,126,669 identified in KTC's recent rate case (Resolution (Res.) T-17081, Appendix C) and KTC's estimated interstate net revenues of \$463,035.

<sup>5</sup> KTC points out that the difference between total funds required for its 5-year cash requirements forecast and the amount requested in the Application may be addressed through a new rate case or another loan.

## 7. Capital Ratios

KTC's capital ratios, as presented by KTC in Exhibit B to the Application and revised by KTC, on January 8, 2008, are shown below, as recorded and as adjusted, to give pro forma effect to the transactions anticipated by the end of 2012:

			(\$)		
	<u>Recorded</u>		<u>Adjustments</u>	<u>Proforma</u>	
Long-term debt	6,996,000	41.05%	3,743,000 (A)	10,739,000	42.47%
Short-term debt	<u>1,000,000</u>	<u>5.87%</u>	<u>(1,000,000)</u> (B)	<u>0</u>	<u>0.00%</u>
Subtotal	7,996,000	46.92%	2,743,000	10,739,000	42.47%
Common Equity	901,000	5.29%	-	901,000	3.57%
Paid In Capital	986,000	5.79%	-	986,000	3.90%
Retained Earnings	<u>7,158,000</u>	<u>42.00%</u>	<u>5,500,000</u> (C)	<u>12,658,000</u>	<u>50.06%</u>
Total Capitalization	<u>17,041,000</u>	<u>100.00%</u>	<u>8,243,000</u>	<u>25,284,000</u>	<u>100.00%</u>

### A. Long-term Debt:

- (1) Issuance of \$7,677,000 debt requested in this Application.
- (2) Current maturities of long-term debt of \$3,934,000.

### B. Short-term Debt:

- (1) Retirement of short-term debt.

### C. Retained Earnings:

- (1) Projected 2008 through 2012 earnings of \$8,000,000 less payment of dividends totaling \$2,500,000.

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Given that 2012 is relatively far off, the determination of how to totally address its 5-year cash requirements has not been made. In addition, the 2012 estimates are pro forma, and may not come to pass.

Consistent with the rate-of-return treatment for regulated local exchange carriers, the Commission, beginning in 1997, merely identifies an overall rate of return, without adopting a capital structure in rate case proceedings of rural Incumbent Local Exchange Carriers.

In KTC's latest general rate case filing, the Commission in Res. T-17081, dated November 1, 2007, merely identified an overall rate of return of 10% for KTC. In D.03-10-006, dated October 2, 2003, in A.02-01-004, the Commission approved a settlement between KTC and the Commission's Office of Ratepayer Advocates that established final rates for KTC, using an overall rate of return of 10%. We make no finding in this decision of the reasonableness of KTC's projected capital ratios.

## **8. Use of Proceeds**

KTC proposes to use the loan proceeds to: 1) replace an existing switch with a new switch, as well as, to replace related electronic equipment, including software; 2) provide a pool of available RUS funds for future projects to improve KTC's network to meet increasing demands for telecommunications services; and 3) finance the cost of engineering to the network improvements.

Using the proceeds of debt issues for the construction or improvement of facilities are proper uses of funds, pursuant to § 817(b).

## **9. Loan Approval**

KTC's request to issue debt is subject to §§ 816 *et seq.*, which provide, in relevant part as follows:

**Section 816:** The power of public utilities to issue... evidences of indebtedness and to create liens on their property situated within this State is a special privilege, the right of supervision, regulation, restriction, and control of which is vested in the

State, and such power shall be exercised as provided by law under such rules as the commission prescribes.

**Section 817:** A public utility may issue stocks and stock certificates or other evidence of interest or ownership, and bonds, notes, and other evidences of indebtedness payable at periods of more than 12 months after the date thereof, for any one or more of the following purposes and no others:

(b) For the construction, completion, extension, or improvement of its facilities.

**Section 818:** No public utility may issue stocks and stock certificates, or other evidence of interest or ownership, or bonds, notes or other evidences of indebtedness payable at periods of more than 12 months..., in addition to the other requirements of law it shall first have secured from the commission an order authorizing the issue, stating the amount thereof and the purposes to which the issue or the proceeds thereof are to be applied...

**Section 851:** No public utility... shall sell, lease, assign, mortgage, or otherwise dispose of or encumber the whole or any part of its... plant, system, or other property necessary or useful in the performance of its duties to the public....without first having secured from the commission an order authorizing it so to do.

The Commission has broad discretion under §§ 816 *et seq.*, to determine if a utility should be authorized to issue debt. The primary standard used by the Commission is whether a utility has demonstrated a reasonable need to issue debt for proper purposes.<sup>6</sup> KTC's proposed network improvements are for the public good, and financing the projects with below market interest loan, are in the best interest of the utility and

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<sup>6</sup> The term "proper purposes" means any expenditure that is necessary or proper to promote legitimate objects of a public utility of the type concerned. (207 Cal 630 (1929).)

ratepayers. We will approve the financing authority requested in the Application. However, we will not make a finding in this decision on the reasonableness of the debt costs.

## **10. Environmental Impact**

The California Environmental Quality Act (Public Resources Code Section 21000, et seq., hereafter “CEQA”) applies to discretionary projects to be carried out or approved by public agencies. A basic purpose of CEQA is to inform governmental decision-makers and the public about the potential and significant environmental effects of proposed activities. (CEQA Guideline Section 15002).

KTC contends in the Application, that CEQA review is not necessary to approve the RUS loan. KTC cited that in D.04-10-037, dated October 28, 2004, the Commission determined that Pacific Gas and Electric Company (PG&E) was not required to undergo a CEQA review as part of its application for approval to issue debt securities, because it was premature to conduct a CEQA review of the projects that may be funded with debt and preferred stock, as PG&E was unable to provide basic details about the potential projects, such as location, design, and engineering. As was the case for PG&E, KTC states that there is insufficient information to conduct a meaningful environmental assessment at this time.

The Commission must act on §§ 818 and 851 applications and must act as either a Lead or Responsible Agency under CEQA. Generally, the Lead Agency is the public agency with the greatest responsibility for supervising or approving the project as a whole (CEQA Guideline Section 15051(b)). CEQA requires that a Responsible Agency consider the Lead Agency’s Environmental Impact Report, Negative Declaration or Mitigated Negative Declaration prior to acting upon or approving a project

(CEQA Guideline Section 15050(b)). The specific activities that must be conducted by a Responsible Agency are contained in CEQA Guideline Section 15096.

It is unknown at this time what the specific project activities and new construction associated with the authority to issue debt will be. The Application specifies that the purpose of the Application is to secure approval for a loan to be used for prospective plant improvements. Securing the financing authority now will put KTC in a better position to undertake plant improvements without delay when construction plans are finalized.

KTC is aware and states in the Application that the utility will comply with all environmental permitting requirements applicable to the projects that it will undertake in conjunction with the proposed debt issue.

Since the details of the proposed improvements are unknown at this time, we will approve the debt financing pursuant to § 818 and § 851 and place KTC on notice that the approval of the loan request does not constitute an implied or expressed waiver of applicable environmental regulations.

This financing order will not authorize any capital expenditure or construction project. KTC will not use the proceeds authorized by this order to begin construction of capital projects until KTC has obtained the required approvals from the Commission, if any, including any required environmental review under CEQA.

## **11. Fees**

Whenever the Commission authorizes a utility to issue debt, the Commission is required to charge and collect a fee in accordance with § 1904(b).

The fee is \$8,677 for this financing authority, as set forth by § 1904(b).<sup>7</sup>

## **12. Categorization and Need for Hearings**

In Res. ALJ 176-3202, dated November 1, 2007, the Commission preliminarily categorized this Application as ratesetting, and preliminarily determined that hearings were not necessary. No protests have been received. Given these developments, a public hearing is not necessary, and there is no need to alter the preliminary determinations made in Res. ALJ 176-3202.

## **13. Waiver of Comment Period**

This is an uncontested matter in which the decision grants the relief requested. Accordingly, pursuant to § 311(g)(2), the otherwise applicable 30-day period for public review and comment is being waived.

## **14. Assignment of Proceeding**

Rami S. Kahlon is the assigned Examiner in this proceeding.

## **Findings of Fact**

1. KTC, a California corporation, is a public utility subject to the jurisdiction of this Commission.

2. KTC appears to need external funds for the purposes set forth in the Application.

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<sup>7</sup> The fee is assessed on \$7,677,000 as follows: (\$2 times (\$1,000,000/\$1,000) plus (\$1 times \$6,677,000/\$1,000) equals \$8,677.

3. The Commission does not by this decision determine that the construction budget, cash requirements forecast, capital structure, and debt costs, presented herein are necessary or reasonable for purposes of setting rates.

4. It is KTC's responsibility to abide by and comply with any applicable environmental regulations for any capital improvement undertaken relative to this debt authorization.

5. Notice of the filing of the Application appeared on the Commission's Daily Calendar of October 31, 2007. There is no known opposition to this Application.

### **Conclusions of Law**

1. A public hearing is not necessary.
2. The Application should be granted to the extent set forth in the order that follows
3. The financing authority sought in this Application is reasonably required for the purposes specified.
4. Authorizing KTC to encumber utility assets as required to secure the loan is for proper purposes and not adverse to the public interest.
5. The financial assistance by RUS provides needed capital for system improvements and is a prudent means of acquiring \$7,677,000 at below market rates.
6. KTC should not use the proceeds from the debt authorized by this order to fund capital projects until KTC has obtained any required Commission approvals for the projects, including any required environmental review under CEQA.
7. KTC should pay the fee determined in accordance with § 1904(b).

8. The following order should be effective on the date of signature.

### **ORDER**

**IT IS ORDERED** that:

1. On or after the effective date of this order, Kerman Telephone Company (KTC), upon terms and conditions substantially consistent with those set forth or contemplated in Application (A.) 07-10-023 (Application), is authorized to enter into a Telephone Loan Contract Amendment with The United States of America, acting through the Rural Utilities Service, for a total sum not exceeding \$7,677,000, for purposes specified in the Application.

2. KTC may execute and deliver the Mortgage Note and supplemental mortgages of the utility's properties on substantially the same terms and conditions as set forth in Exhibit C to the Application.

3. KTC shall keep and maintain copies of the Telephone Loan Contract Amendment, the Mortgage Notes, and Supplemental Mortgages, and provide copies to the Division of Water and Audit's Utility Audit, Finance and Compliance Branch (UAFCB), within thirty days from request.

4. This financing order does not authorize any capital expenditures or construction projects. KTC shall not use the proceeds authorized by this order to begin construction of capital projects until KTC has obtained the required approvals from the Commission, if any, including any required environmental review under the California Environmental Quality Act.

5. On or before the 25<sup>th</sup> day of each month, KTC shall file with the UAFCB the reports required by General Order Series 24.

6. The authority granted by this order shall become effective when KTC pays \$8,677, as required by Public Utilities Code § 1904(b).

7. The Application is granted as set forth above.

8. A.07-10-023 is closed.

This order is effective today.

Dated February 28, 2008, at San Francisco, California.

MICHAEL R. PEEVEY

President

DIAN M. GRUENEICH

JOHN A. BOHN

RACHELLE B. CHONG

Commissioners

Commissioner Timothy Alan Simon, being necessarily absent, did not participate.