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Decision 84 07 010 JUL 5 1984

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of SOUTHWEST GAS CORPORATION for Authority to Establish an Intermediate Term Credit Facility to Issue and Sell Commercial Paper Notes and/or Notes Payable to Banks and Issue and Sell Preferred or Preference Stock not to Exceed $130 Million in Aggregate Outstanding Principal Amount.	Application 84-03-091 (Filed March 30, 1984; amended April 18, 1984 and April 26, 1984)

OPINION

Southwest Gas Corporation (Southwest) requests authority, under Public Utilities (PU) Code Sections 818 through 830 and 851, for the following:

1. To establish an intermediate term credit facility (Credit Facility), to issue and sell commercial paper notes and/or notes payable to banks up to $130,000,000 in aggregate principal amount;

2. To issue and sell up to $25,000,000 of its preferred or preference stock (Preferred Shares);

3. To issue and sell up to $80,000,000 of its first mortgage bonds, and to execute and deliver a supplemental trust indenture (New Indenture); and,

4. To exempt from the Commission's competitive bidding requirements, the sale of intermediate or long-term debt that may be issued in connection with the Credit Facility.

The commercial paper notes, notes payable to banks, first mortgage bonds, and other evidences of indebtedness are referred to collectively as Debt Securities.

The sum of all Debt Securities and Preferred Shares will not exceed $130,000,000 in aggregate principal amount.

Summary of Decision

This decision grants Southwest the authority requested in the application, as amended. The decision grants the authority to issue and sell its Debt Securities by either competitive bidding, negotiated public offerings or by negotiated private placements. This decision also requires that Southwest file a report showing why the interest rate and cost of money, resulting from negotiated public offerings or negotiated private placements, were the most advantageous to the company and its ratepayers.

Notices of the filing of the application, as amended, appeared on the Commission's Daily Calendars of April 3, April 23 and May 1, 1984. No protests have been received.

Southwest, a California corporation, distributes and sells natural gas in portions of San Bernardino and Placer Counties. Also, the utility transmits, sells and distributes natural gas in portions of the states of Nevada and Arizona.

Based on Southwest's Statement of Income for the year ended December 31, 1983, the utility reported total operating revenues of $384,859,780 and net income of $16,651,005, shown as part of Exhibit A attached to the application, as amended. Southwest reports the utility derived 11.09% of its revenues from operations in California.

Southwest's Balance Sheet as of December 31, 1983, also attached as part of Exhibit A to the application, as amended, is summarized as follows:

Assets		Amount
Net Utility Plant		$269,151,101
Other Property and Investments		8,376,473
Current and Accrued Assets		66,567,237
Deferred Debits		5,777,882
	Total	$349,872,693

Liabilities and Equity		
Common Stock Equity		$ 98,223,821
Preferred/Preference Stock		33,580,000
Long-Term Debt		95,284,058
Current and Accrued Liabilities		93,419,365
Deferred Credits		29,365,449
	Total	$ 349,872,693

Southwest alleges a need to obtain a maximum of $130,000,000 of additional financing in the form of a Credit Facility, in order to purchase all of the gas utility assets (Gas Assets) of Arizona Public Service Company (APS).

In October of 1983, Southwest and APS executed an agreement in principle (Agreement) pursuant to which Southwest will acquire all of the Gas Assets of APS, on or after September 30, 1984, subject to fulfillment of certain conditions. These Gas Assets consist of a complete gas distribution system and gas utility plant, together with franchises, gas supply contracts, construction and transportation equipment, vehicles, and generally, other tools, equipment and assets used by APS in providing natural gas distribution service. At September 30, 1983, these Gas Assets were recorded by APS at a cost of $193,870,000, less reserves for depreciation and amortization of $72,914,000.

The Agreement contains provisions for determining the purchase price and the method of payment. The formula, which considers future actual operating results of the Gas Assets for the twelve months ended July 31, 1984 adjusted for various items of revenues and expenses on a pro forma basis, will establish a purchase price between 85% and 100% of the net book value of the Gas Assets. Currently, Southwest estimates that the purchase price will be between $107,000,000 and $126,000,000.

The gas service area of APS to be acquired by Southwest contains approximately 15,000 square miles, that includes the Phoenix metropolitan area, and certain other communities in central, southeast, and southwest Arizona. Southwest will acquire approximately 340,000 gas customers, of which more than 312,000 are residential and the balance consist of commercial and industrial users. Sales to residential and commercial customers resulted in approximately 73% of total 1982 distribution revenues of $198,000,000.

The Agreement provides that payment of the purchase price will consist of cash and under certain circumstances as determined by the formula, up to $25,000,000 of Southwest's Preferred Shares. In order for the utility to initially fund the purchase price of the Gas Assets, Southwest requests authorization from the Commission for the following:

1. To establish a Credit Facility, to issue and sell Southwest's commercial paper notes and/or notes payable to banks up to $130,000,000 in aggregate principal amount;

2. To issue and sell up to $25,000,000 of Preferred Shares;

3. If necessary, to issue and sell up to $80,000,000 of Southwest's first mortgage bonds to itself, and to execute and deliver a New Indenture. Then, Southwest would pledge the first mortgage bonds to the various lenders as security for any

> loans in connection with the Credit Facility. Any first mortgage bonds, that are issued, sold and pledged as security, would be endorsed in blank as payable to a collateral agent for the lenders. If default occurs, the collateral agent would have the right to take possession of the first mortgage bonds and have these securities transferred to the names of the lenders. Additionally, one of the first mortgage bonds with a face value of $10,000 would be issued directly to the collateral agent in his own name. Then, the collateral agent could vote this first mortgage bond under the provisions of Southwest's original Indenture that provides for voting rights in respect of each of the series of first mortgage bonds.

Southwest anticipates that commercial paper notes, notes payable to banks, and Preferred Shares issues will be refunded over a period of time by increments of additional debt and equity securities.

Exemption from Competitive Bidding

Southwest requests an exemption for the sale of its Debt Securities from the Commission's competitive bidding rule. The rule was established by Commission Decision (D.) 38614 dated January 15, 1946 in Case 4761, as amended by D.49941, D.75556 and D.81908, which generally requires California Public Utilities to obtain competitive bids for the issue and sale of their debt securities.

In the application, as amended, Southwest sets forth the following reasons to justify the utility's request to issue and sell Debt Securities exempt from the competitive bidding rule:

1. Due to the size of the company, Southwest does not have the investor attraction associated with larger and more diversified companies. Consequently, Southwest's bonds have a very small public market and limited institutional following. As a result, the use of a competitive bid to sell additional Debt Securities would most likely be more costly than an offering made on a negotiated basis, since those bidding on Southwest's proposed bonds must take into account the additional risk inherent in an issue that is limitedly marketable.

2. Southwest's first mortgage bonds (its senior debt securities) are rated BBB by Standard & Poor's and Baa-3 by Moody's Investors Service. This quality rating severely limits the potential market for Southwest's Debt Securities. The relatively recent downgrading of Southwest's bonds by Moody's Investors Service has further hampered the ability of Southwest to sell the utility's bonds and other forms of long-term debt. The primary avenue for marketing these securities is through private placements with institutional (insurance companies) investors. This market makes preoffering marketing efforts essential by the prospective underwriters. Investment bankers associated with the negotiating group in a negotiated underwriting are in a position to engage in these efforts, but members of a bidding group are not able and/or will not engage in such efforts.

These efforts, together with the greater flexibility in timing and terms, can result in a lower cost of money through a negotiated underwriting, than would be obtained if the offering were made by means of competitive bidding.

3. The fact that Southwest might be authorized to enter into a sale of its Debt Securities on a negotiated basis would not necessarily result in an offering at a higher cost than that obtainable through a competitive bid. In a negotiated transaction, Southwest negotiates with a number of agents <u>before</u> selecting any one in particular. In this manner, Southwest is able to obtain the best possible terms and conditions.

4. In seeking authority to issue the utility's Debt Securities by negotiated private placement, Southwest believes that the terms and conditions of a private placement sale can be tailored to meet the requirements of institutional investors, in order to obtain a more favorable interest rate on the Debt Securities than that available through a public offering.

5. The $80,000,000 of first mortgage bonds that may be issued in connection with the Credit Facility, are to be issued to Southwest and then pledged to the various lenders as security for such credit. Consequently, insofar as the terms of the Credit Facility relate to the issuance and sale of the first mortgage bonds, a competitive bid offering is simply inappropriate in this case, as Southwest will be the only significant purchaser and there will be no bidders.

Southwest believes that in order to serve the best interests of the utility, its ratepayers, and its shareholders, Southwest requires the greater flexibility in the method of sale of the utility's Debt Securities provided by negotiated sales, rather than that provided by competitive bidding.

In order to provide Southwest with greater financial flexibility, the Revenue Requirements Division recommends that Southwest be granted the authority to issue the proposed Debt Securities by a competitive offering.

We are persuaded that an inflexible adherence to the requirements of the competitive bidding rule may not be in the public interest, given Southwest's low bond rating (BBB), and its need for large amounts of capital in a period of increasing competition for available funds. Moreover, the Federal Government's need to finance extraordinary budget deficits, while the private sector borrowing demands are expanding, has put upward pressure on interest rates. These considerations warrant granting Southwest maximum flexibility in this financing program.

Consequently, for this amended application only, we will authorize Southwest to proceed on either competitive bidding, negotiated public offerings or private placements, according to Southwest's estimation of where the most favorable opportunity lies.

If Southwest chooses to issue and sell the proposed Debt Securities by means of negotiated public offerings or by private placements, we place Southwest on notice that in the utility's next general rate proceeding before the Commission, the reasonableness of the resulting interest rate and cost of money to the utility will be closely scrutinized and may result in disallowance of the interest expense, if it is determined that the cost of money incurred was not prudent. Also, we will require Southwest to provide us with a showing of why the utility believes that the resulting interest rate and cost of money were the most advantageous to Southwest and its ratepayers. We will require this showing within a reasonable period of time after the issuance and sale of the proposed Debt Securities.

Southwest's capital ratios as of March 31, 1984 are shown below as recorded and adjusted to give pro forma effect to the transactions that follow:

Component	March 31, 1984	Pro Forma
Long-Term Debt	40.1%	63.4%
Short-Term Debt	1.1	.7
Total	41.2%	64.1%
Preferred/Preference Stock	9.1	5.5
Common Stock Equity	49.7	30.4
Total	100.0%	100.0%

1. The proposed issuance and sale of up to $20,000,000 aggregate principal amount of Southwest's long-term indebtedness subsequent to March 31, 1984. (Authorized by D.82-11-060 dated November 17, 1982 in Application (A.) 82-09-025).

2. The proposed issuance and sale of up to $130,000,000 aggregate principal amount of Southwest's Debt Securities as requested in this application, as amended.

3. If Southwest proposes to issue and sell up to $105,000,000 of its Debt Securities and up to $25,000,000 of its Preferred Shares, the sum of which will not exceed $130,000,000 aggregate principal amount, as requested in this application, as amended, the pro forma capital ratios are estimated as follows: (a) Long-Term Debt 57.0%, (b) Short-Term Debt .6%, (c) Preferred/Preference Stock 12.0%, and (d) Common Stock Equity 30.4%.

The Commission's Revenue Requirements Division has analyzed Southwest's cash requirements forecasts, shown as part of Exhibit B attached to the application, as amended. The Division has concluded that internally generated funds will provide only 12.7% of capital expenditures for 1984, 48.4% for 1985 and 32.5% for 1986. Also, the Division has concluded that the proposed sale of Southwest's securities, as requested in the application, as amended, is necessary to help meet forecasted cash requirements, which include capital expenditures. However, the Division reserves the right to reconsider, in future rate proceedings, the reasonableness of the capital cost resulting from the acquisition of the Gas Assets from APS.

Findings of Fact

1. Southwest, a California corporation, operates as a public utility under the jurisdiction of this Commission.

2. The proposed sale of Debt Securities and Preferred Shares would be for proper purposes.

3. Southwest needs external funds for the purposes set forth in the application, as amended.

4. The money, property or labor to be procured or paid for by the proposed Debt Securities and Preferred Shares is reasonably required for the purposes specified in the application, as amended.

5. The sale of the proposed Debt Securities should not be required to be through competitive bidding.

6. There is no known opposition to the application, as amended, and no reason to delay granting the authority requested.

Conclusions of Law

1. A public hearing is not necessary.

2. The application, as amended, should be granted to the extent set forth in the order which follows.

3. The proposed issue of Debt Securities and Preferred Shares is for lawful purposes and the money, property, or labor to be obtained by them is required for these purposes. Proceeds from the issue of Debt Securities and Preferred Shares may not be charged to operating expenses or income.

This authorization is not a finding of the value of Southwest's stock or property, nor does it indicate the cost of capital to be included in ratesetting proceedings.

The following order should be effective on the date of signature and payment of the fee set by PU Code Section 1904.2, to enable Southwest to proceed with the utility's issue and sale of the Debt Securities and Preferred Shares expeditiously.

O R D E R

IT IS ORDERED that:

1. Southwest Gas Corporation (Southwest), on or after the effective date of this order, may establish an intermediate term credit facility (Credit Facility), to issue and sell commercial paper notes and/or notes payable to banks up to $130,000,000 in aggregate principal amount, by means of competitive bidding, negotiated public offerings, or negotiated private placements.

2. Southwest may issue and sell up to $25,000,000 of preferred or preference stock (Preferred Shares).

3. Southwest may issue and sell up to $80,000,000 of its first mortgage bonds by means of competitive bidding, negotiated public offerings, or negotiated private placements. Southwest may pledge the first mortgage bonds to various lenders, as security for any loans in connection with the Credit Facility.

4. The sum of all commercial paper notes, notes payable to banks, first mortgage bonds, and other evidences of indebtedness (Debt Securities) and preferred or preference stock (Perferred Shares) authorized by this decision will not exceed $130,000,000 in aggregate principal amount and are to be issued in accordance with the terms and conditions set forth in the application, as amended.

5. Southwest may execute and deliver a supplemental trust indenture (New Indenture) in connection with the first mortgage bonds, and any first mortgage bonds issued, sold and pledged as security, would be endorsed in blank as payable to a collateral agent for the lenders.

6. Southwest's financings through negotiated public offerings and negotiated private placements are exempted from the Commission's competitive bidding requirements.

7. Southwest shall apply the net proceeds from the sale of its Debt Securities and Preferred Shares for the purposes set forth in the application, as amended.

8. Promptly after Southwest awards any contract for the sale of its Debt Securities, if by competitive bidding, Southwest shall file a written report with the Commission showing, for each bid received, the name of the bidder, the price, the interest rate, and the cost of money to Southwest based on the price and interest rate.

9. If the Debt Securities are sold by competitive bidding or by negotiated public offerings, as soon as possible, Southwest shall file with the Commission three copies of its final prospectus pertaining to the Debt Securities.

10. Within 30 days after the issuance and sale of any series of Debt Securities by means of negotiated public offerings or negotiated private placements, Southwest shall file with the Commission a report showing why the resulting interest rate and cost of money were the most advantageous to the utility and its ratepayers.

11. Southwest shall file the reports required by General Order Series 24.

12. The authority granted by this order will become effective when Southwest pays $13,208.50, the fee set by PU Code Section 1904.2. In all other respects, this order is effective today.

13. The application, as amended, is granted as set forth above.

Dated JUL 5 1984, at San Francisco, California.

LEONARD M. GRIMES, JR.
President
VICTOR CALVO
PRISCILLA C. GREW
DONALD VIAL
WILLIAM T. BAGLEY
Commissioners

PUBLIC UTILITIES COMMISSION
STATE OF CALIFORNIA
PAID
JUL 9 1984
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By

I CERTIFY THAT THIS DECISION WAS APPROVED BY THE ABOVE COMMISSIONERS TODAY.

Joseph E. Bodovitz, Executive Director