CACD/KLH

Decision 87 12 042

DEC 17 1987

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ORIGINAL

Application of PACIFIC GAS AND ELECTRIC COMPANY to (i) issue, sell and deliver one or more series of its First and Refunding Mortgage Bonds, debentures, promissory notes and/or other evidences of indebtedness in connection with domestic or Euromarket offerings and (ii) guarantee the obligations of others in respect of the issuance of securities, the total aggregate principal amount of such issuances not to exceed $1,000,000,000; to issue shares of its Common Stock upon conversion of convertible debt securities; and for an exemption from the Competitive Bidding Rule. (U 39 M)	Application 86-12-066 (Filed December 31, 1986; Petition for Modification Filed April 10, 1987; Petition for Modification Filed November 3, 1987)

SUPPLEMENTAL OPINION

Summary of Decision

This decision grants Pacific Gas and Electric Company (PG&E) the authority requested in its petition for modification.

Notice of the filing of the petition for modification appeared on the Commission's Daily Calendar on November 6, 1987. No protests have been received.

By Decision (D.)87-03-069 dated March 25, 1987 in Application (A.)86-12-066, the Commission authorized PG&E, among other things, to issue and sell, in one or more series, on or prior to December 31, 1988, Debt Securities not to exceed the aggregate principal amount of $1,000,000,000. By D.87-05-048 dated May 29, 1987, the Commission modified D.87-03-069 to allow for an exemption from the Commission's Competitive Bidding Rule for the issuance and sale of PG&E's Debt Securities sold by means of negotiated public offerings of $300,000,000 aggregate principal amount, or larger.

PG&E has requested a further modification of A.86-12-066 for the following:

1. To issue and sell, in one or more series, its First and Refunding Mortgage Bonds, debentures, convertible debentures, debentures with warrants, promissory notes and/or other evidences of indebtedness (to be collectively referred to as Debt Securities) through means of negotiated public offerings exempt from the Commission's Competitive Bidding Rule for a period of six months from the date of this decision on the Petition for Modification and

2. In all other respects, D.87-03-069 (as modified by D.87-05-048) to remain in full force and effect.

Exemption from the Competitive Bidding Rule

Under Commission Resolution F-616 dated October 1, 1986, the Commission may grant exemptions from the Competitive Bidding Rule for debt issues for which competitive bidding is not viable or available. PG&E has stated that recent market events and the current instability in the capital markets have affected the availability and viability of competitive bidding in the markets. PG&E believes that compelling circumstances exist for requesting an exemption from the Competitive Bidding Rule for Debt Securities issued during the next six months and that the exemption would afford it the flexibility to meet its financial requirements on the most favorable terms available.

PG&E states in its petition for modification of D.87-03-069 that as a result of recent market events, including the one-day 508 point decline in the Dow Jones Industrial Average on October 19, 1987 and the extreme volatility in the stock and bond markets over a long period of time, issuing Debt Securities through a competitive bid was not available to companies for a period of at least one week. During the period from October 19, 1987 to October 26, 1987, no company attempted to issue debt through a competitive bid even though several had been scheduled. In fact, during that period several companies that typically issue debt securities, using a competitive bidding process, issued debt securities through a negotiated offering. These companies include Southern California Edison, Consolidated Natural Gas, General Electric Credit Corporation, Associates Corporation and Household Finance. In addition, on October 22, 1987, Alabama Power withdrew its plans for a competitive bid because it believed it would not receive any bids.

PG&E states that on October 26, 1987, Eastman Kodak, an AAA-rated company, was the first company to attempt a competitive bid a four-year non-call $300,000,000 issue, all bids were taken as a spread over the Treasury rate rather than an absolute rate. This enabled the underwriters to bid on the deal because they were less exposed to the risk of the rapidly fluctuating Treasury rates.

PG&E states in its petition that although competitive bids have been utilized in recent days, the results of these bids suggest that competitive bids may not result in the lowest cost of money for the issuer. For instance, the first utility competitive bid since October 19, 1987 was Central Power & Light's seven-year debt issue on October 27, 1987. Although several groups entered bids, the winning bid was 118 basis points over the seven-year Treasury rate. Before the extreme volatility of the capital markets, PG&E's investment bankers advised it that Central Power & Light could have issued debt securities at about 70 to 75 basis points of the the seven-year Treasury. Although spreads have generally widened recently, PG&E's investment bankers estimate that a negotiated offering would have resulted in a cost of money of 10 basis points less than the competitive bid. In fact, the reason Central Power & Light used a competitive bidding process was not because it would result in the lowest cost of money, but because they were required to as a holding company under the Public Utilities Holding Company Act of 1935.

Exhibit A attached to the petition for modification shows the extreme volatility in the bond market during the month of October 1987. Although the market has stabilized somewhat, the shock of the past few weeks and the uncertainty in the markets are likely to continue for a period of time. During this period, PG&E believes that issuing Debt Securities, on a negotiated basis, will result in a cost of money at least as low as that achieved on a competitive bid basis.

PG&E also states that the negotiated offering process ensures an active pre-pricing marketing effort by the underwriters that does not occur in the context of the competitive offering. In periods of extreme volatility in the markets, underwriters are likely to charge a premium for taking the risk of bidding on a deal (prospective bond issue) where there has not been a pre-marketing period for the underwriters to build their book (potential demand or buyer interest). In a negotiated transaction, institutions interested in purchasing an issue tend to register their interest earlier in an attempt to ensure that their order will be filled. In contrast, potential investors are less inclined to indicate their interest to various bidding groups, since they have no knowledge about which group will win the bid.

Furthermore, PG&E states that a negotiated offering gives PG&E the benefit of the marketing and capital strength of a syndicate group including all the major investment banking firms, as opposed to a competitive bid which fragments these firms into two or more bidding groups. Fragmentation of underwriting strength reduces the ability of any single group to spread the risk and often results in a higher cost of money to the issuer, particularly in a weak or volatile market.

PG&E believes that for the foregoing reasons the sale of its Debt Securities during the next six months through negotiated offerings would enable it to obtain a cost of money at least as low as, if not lower, than that determined by sale under competitive bidding requirements. Therefore, PG&E believes it is in the best interest of its ratepayers that the proposed issue, or issues, of Debt Securities be exempt from the Competitive Bidding Rule during this period.

The Commission Advisory and Compliance Division (CACD) has reviewed PG&E's request and its reasons for an exemption from the Commission's Competitive Bidding Rule as modified by Commission Resolution F-616. CACD has determined that PG&E has valid reason for an exemption during the period of capital market volatility and recommends that an exemption be given PG&E for the next six months.

We will accept the recommendation of CACD. We place PG&E on notice that if it chooses to issue and sell its Debt Securities by means of negotiated private placements or negotiated public offerings, 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 prudent. We will also require PG&E to provide us with a showing of why it believes that the resulting interest rate and cost of money were advantageous to PG&E and its ratepayers. We will require this showing within a reasonable period of time after issuance of its Debt Securities.

Findings of Fact

1. The issue and sales, in one or more series of the proposed Debt Securities for a period of six months should not be required to be through competitive bidding.

2. The issue and sale of the proposed Debt Securities, under an exemption from the Competitive Bidding Rule would not be adverse to the public interest.

3. There is no known opposition to the proceeding and no reason to delay granting the authority requested.

Conclusions of Law

1. A public hearing is not necessary.

2. The petition for modification should be granted to the extent set forth in the supplemental order that follows.

The following supplemental order should be effective on the date of signature to enable PG&E to proceed with the proposed financing expeditiously.

SUPPLEMENTAL ORDER

IT IS ORDERED that:

1. The authority granted to Pacific Gas and Electric Company (PG&E) by Decision (D.)87-03-069 as modified by D.87-05-048 to issue and sell its Debt Securities up to the aggregate principal amount of $1,000,000,000, is modified as follows: PG&E's proposed public sales of Debt Securities for a period of

six months, from the date of this order, are exempt from the Commission's Competitive Bidding Rule as modified by Resolution F-616.

2. PG&E, within 30 days after the issuance and sale of its Debt Securities by means of negotiated private placement or negotiated public offerings, shall file a report, with the Commission Advisory and Compliance Division, setting forth the reason the company believes the resulting interest rate and cost of money were advantageous to the company and its ratepayers.

3. The petition for modification is granted as set forth above.

In all other respects, D.87-03-069 as modified by D.87-05-048 remains in full force and effect.

This order is effective today.

Dated DEC 1 7 1987, at San Francisco, California.

STANLEY W. HULETT
President
DONALD VIAL
FREDERICK R. DUDA
G. MITCHELL WILK
JOHN B. OHANIAN
Commissioners

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

Victor Weisser

Victor Weisser, Executive Director

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3. The petition for modification is granted as set forth above.

In all other respects, D.87-03-069 as modified by D.87-05-048 remains in full force and effect

This order is effective today.

Dated DEC 17 1987, at San Francisco, California.

STANLEY W. HULETT
President
DONALD VIAL
FREDERICK R. DUDA
G. MITCHELL WILK
JOHN B. OHANIAN
Commissioners