

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of PACIFIC GAS AND
ELECTRIC COMPANY to 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 to
guarantee the obligations of others
in respect of the issuance of
securities, the total aggregate
principal amount of such issuances
and guarantees not to exceed
\$1,000,000,000; to issue shares of
its Common Stock upon conversion of
convertible debt securities or the
exercise of equity warrants; to
enter into one or more interest
rate swap agreements; and for an
exemption from the Competitive
Bidding Rule.

Application 88-02-007
(Filed February 3, 1988)

(U-39-M)

O P I N I O N

Summary of Decision

This decision grants Pacific Gas and Electric Company
(PG&E) the authority requested in the application.

PG&E requests authority under Public Utilities (PU) Code
Sections 816 through 830 and 851, for the following:

1. a. To issue and sell, in one or more series,
PG&E's First and Refunding Mortgage Bonds
(Bonds), debentures, convertible debentures,
debentures with warrants, promissory notes,
and/or other evidences of indebtedness (to be
collectively referred to as Debt Securities)
and/or

- b. To unconditionally guarantee, or otherwise secure, the obligations issued by, or on behalf of, the State of California or any political subdivision, including but not limited to the California Pollution Control Financing Authority (to be collectively referred to as the Authorities or individually as the authority), the proceeds of which are to be used to finance or refinance air and water pollution control facilities, sewage systems, solid waste disposal facilities, any other facilities qualifying for tax-exempt financing under the Internal Revenue Code, or any combination thereof (to be collectively referred to as the Qualified Facilities).

The total aggregate principal amount of these issues and/or guarantees shall not exceed the aggregate principal amount of \$1,000,000,000;

2. To enter into one or more interest rate swap agreements pursuant to PU Code Sections 816 through 830.
3. To sell the proposed issue or issues of Debt Securities pursuant to the Commission's Competitive Bidding Rule with the following modifications:
 - a. Exemption from the Competitive Bidding Rule for negotiated public offerings of \$300,000,000 principal amount or greater,
 - b. Exemption from the Competitive Bidding Rule for the issuance of Medium-Term Notes on a continuous or periodic basis through dealers on a best-efforts or agency basis,
 - c. Exemption from the Competitive Bidding Rule for interest rate swaps and exemption from the Competitive Bidding Rule for Debt Securities issued in connection with interest rate swaps,

- d. The elimination of the one-day notification requirement specified in the Competitive Bidding Rule, and
- e. Exemption from the Competitive Bidding Rule for Debt Securities issued during 1988;
- 4. To issue shares of PG&E's Common Stock
 - a. In exchange for and upon retirement of the Debt Securities, or
 - b. In exchange for equity warrants upon exercise of these warrants, as may be required from time to time;
- 5. To be relieved of the necessity of complying with the Commission's General Order Series 24-B, for the issuance of Medium-Term Notes;
- 6. To use the net proceeds (exclusive of accrued interest) for the purposes set forth in the application; and
- 7. To use any accrued interest received in connection with the issue or issues of Debt Securities for general corporate purposes.

A more complete statement of the authorization sought by PG&E is set forth in the application and summarized below.

Notice of the filing of the application appeared on the Commission's Daily Calendar of February 8, 1988. No protests have been received.

PG&E, a California corporation, operates as a public utility subject to the jurisdiction of this Commission. PG&E generates, purchases, transmits and sells electricity and purchases, transports, distributes and sells natural gas to 47

counties in Central and Northern California. The company also provides a small amount of incidental water and steam services.

For the 12 months ended September 30, 1987, PG&E reported it generated total utility operating revenues of \$7,313,047,000 and net income of \$775,618,000 as indicated in its Income Statement shown as part of Exhibit B attached to the application.

Also shown as part of Exhibit B is PG&E's Balance Sheet as of September 30, 1987, summarized as follows:

<u>Assets</u>	<u>Amount</u>
Net Utility Plant	\$16,112,462,000
Gas Stored Underground -	
Noncurrent.	44,041,000
Other Property and Investments	734,957,000
Current and Accrued Assets	2,340,024,000
Deferred Debits	<u>1,908,516,000</u>
Total	\$21,140,000,000
<u>Liabilities and Equity</u>	
Common Equity	\$ 7,165,174,000
Preferred Stock	1,220,195,000
Long-Term Debt	7,798,233,000
Other Noncurrent Liabilities	483,715,000
Current and Accrued Liabilities	1,623,616,000
Deferred Credits	<u>2,849,067,000</u>
Total	\$21,140,000,000

As of September 30, 1987, PG&E's construction expenditures unreimbursed from the sale of securities amounted to \$7,938,289,000 as shown in Exhibit C attached to the application.

Construction Budgets

PG&E's construction budgets for the years 1988, 1989, and 1990 amount to about \$3,626,000,000 estimated as of November 20, 1987. Major classifications of the total budgeted construction are summarized as follows:

<u>Component</u>	<u>1988</u>	<u>1989</u> (In Thousands)	<u>1990</u>
Electric Department	\$1,032,000	\$ 893,000	\$ 765,000
Gas Department	304,000	307,000	235,000
Other Common Plant	<u>90,000</u>	<u>0</u>	<u>0</u>
Total	<u>\$1,426,000</u>	<u>\$1,200,000</u>	<u>\$1,000,000</u>

The Commission Advisory and Compliance Division (CACD) has reviewed PG&E's construction budgets for the years 1988, 1989 and 1990 and has concluded that PG&E's proposed sale of securities, as requested in the application, is necessary to partially reimburse PG&E's treasury for capital additions and improvements to its utility plant or to fund the planned construction. However, PG&E is placed on notice, by this decision, that the Commission does not find that PG&E's construction program is necessary, or reasonable, for ratemaking purposes. These are issues normally tested in general rate or rate base offset proceedings.

Cash Requirements Forecasts

PG&E's cash requirements for the years 1988 and 1989, estimated as of October 1987 is summarized as follows:

	<u>1988</u>	<u>1989</u>
Funds Used/or Required for Construction Expenditures (Excluding AFUDC)	\$1,368,000,000	\$1,121,000,000
Maturities and Redemption of Long-Term Debt, Includ- ing Sinking Funds Require- ments and Preferred Stock	1,280,912,000	181,294,000
Short-Term Debt Outstand- ing as of Beginning of Year	<u>(50,000,000)</u>	<u>(43,000,000)</u>
Subtotals	<u>\$2,598,912,000</u>	<u>\$1,259,294,000</u>
Less: Estimated Cash Avail- able from Internal Sources	\$ <u>619,912,000</u>	\$ <u>700,294,000</u>
Additional New Funds Re- quired from Outside Sources	\$1,979,000,000	\$ 559,000,000

The CACD has analyzed PG&E's cash requirements forecasts shown above and as indicated by the utility in its supplemental data sheets and a subsequent letter dated March 2, 1988 presented to the Commission and has concluded that internally generated funds will provide about 23.9% of the 1988 cash requirements, or \$619,912,000, and about 55.6% of the 1989 cash requirements, or \$700,294,000. The CACD concludes that PG&E's proposed sale of securities, as requested in the application, is necessary to help meet forecasted cash requirements. PG&E will need additional cash from outside sources of \$1,979,000,000 in 1988 and \$559,000,000 in 1989.

Capital Ratios

PG&E's capital ratios as of September 30, 1987 are shown below as recorded and as adjusted to give pro forma effect to the transactions that follow:

	<u>September 30, 1987</u>	<u>Pro Forma</u>
Long-Term Debt	47.3%	47.5%
Short-Term Debt	1.2	8.8
Total Debt	48.5%	56.3%
Preferred Stock	7.5	6.9
Common Equity	<u>44.0</u>	<u>36.8</u>
Total	100.0%	100.0%

Debt

1. Credit Facilities not exceeding \$1,000,000,000 aggregate principal amount (authorized by Decision (D.) 86-08-051 dated August 18, 1986 in Application (A.) 86-05-012). (Standby lines of credits with banks in the amount of \$650,000,000 have been executed but no borrowings have been made);
2. The remaining issuance of long-term debt obligations from PG&E to the State of California, Department of Water Resources in an aggregate principal amount of \$99,728,309 (authorized in the amount of \$73,500,000 by D.82-12-008 dated December 1, 1982 in A.82-10-55 and as increased to \$136,000,000 in D.86-08-024 dated August 6, 1986);
3. The proposed remaining issuance of Debt Securities not exceeding \$281,350,000 aggregate principal amount (authorized by D.87-03-069 dated March 25, 1987 in A.86-12-066);
4. The retirement at maturity of \$55,957,000 aggregate principal amount of outstanding First and Refunding Mortgage Bonds during the last quarter of 1987 and in 1988 and 1989;

5. The redemption of (a) \$161,200,000 aggregate principal amount to meet sinking fund requirements and (b) \$329,390,000 aggregate principal amount for other purposes, during the last quarter of 1987 and in 1988 and 1989);
6. The issuance of \$315,000,000 of tax exempt Debt Securities on behalf of PG&E by the authority on December 17, 1987 (authorized by D.87-03-069 dated March 25, 1987 in A.86-12-066);
7. The proposed issuance of up to \$1,000,000,000 aggregate principal amount of Debt Securities (authorized by D.87-12-002 dated December 9, 1987 in A.87-10-010);
8. The redemption of \$925,000,000 of outstanding exempt bonds issued on behalf of PG&E by the Authority;
9. The proposed issuance of up to \$1,000,000,000 aggregate principal amount of Debt Securities requested in this application;
10. The issuance of the maximum amount of short-term debt securities (authorized by D.93788 dated December 1, 1981 in A.60949, and in D.87-09-056 dated September 23, 1987 in A.87-08-008) for a total of \$1,634,472,769 aggregate principal amount;

Preferred Stock

11. The proposed issuance of Preferred Stock with an aggregate par value not exceeding \$75,000,000 (authorized by D.84-07-116 dated July 18, 1984 in A.84-04-116;
12. The sinking fund requirements totaling \$45,000,000 aggregate par value during the last quarter of 1987, and in 1988 and 1989;
13. The proposed issuance of Preferred Stock with an aggregate par value not exceeding \$200,000,000 (authorized in D.87-12-002 dated December 9, 1987 in A.87-10-010);

Common Stock

14. The issuance of 9,447,900 shares of Common Stock remaining in connection with the existing Shelf Registration Program having estimated proceeds of \$151,166,400 using a stock price of \$16.00 (authorized by D.85-08-098 dated August 21, 1985 in A.85-06-043);
15. The issuance of 5,716,807 shares of Common Stock remaining in connection with the Savings Fund Plan having estimated proceeds of \$91,468,912 using a stock price of \$16.00 (authorized by D.84-09-002 dated September 6, 1984 in A.84-07-044 and D.87-02-021 dated February 11, 1987 in A.86-12-067);
16. The issuance of 16,720,821 shares of Common Stock remaining in connection with the Dividend Reinvestment and Common Stock Purchase Plan having estimated proceeds of \$267,533,136 using a stock price of \$16.00 (authorized by D.87-08-035 dated August 26, 1987 in A.87-07-065); and
17. The issuance of 1,500,000 shares of Common Stock in connection with the Stock Option Plan having estimated proceeds of \$24,000,000 using a stock price of \$16.00 (authorized by D.86-10-043 dated October 16, 1986 in A.86-08-001).

The pro forma capital ratios, as set forth above, do not include any future adjustments to retained earnings. Also, PG&E has stated that the maximum amount of short-term debt securities authorized by statute and Commission decision is unlikely to be outstanding for any long period of time before being refinanced by other securities, which are also included in the pro forma capital ratios. In addition, due to the uncertain timing of the issuances of the debt, preferred stock and common

stock previously authorized, and the future economic feasibility of redeeming or refunding of PG&E's debt and preferred stock securities, the utility has stated that the pro forma capital ratios may not be achieved.

Summary of Proposed Debt Securities

PG&E seeks authority to issue and sell, in one or more series, Debt Securities and/or to unconditionally guarantee, or otherwise secure, the obligations of the Authorities in respect of their issuance of debt in connection with the tax-exempt financings of Qualified Facilities. Total issuance of Debt Securities and/or unconditional guarantees shall not exceed the aggregate principal amount of \$1,000,000,000.

The terms and conditions of the proposed Debt Securities, including the price, interest rate, maturity date, redemption provisions, sinking fund (if any), and other provisions will be determined by market conditions at the time of sale of each series of the Debt Securities.

Debt Securities may be sold by means of competitive bidding, negotiated public offerings or other offerings exempt from the Commission's Competitive Bidding Rule set forth in D.38614 dated January 15, 1946 in Case 4761, as amended by D.49941, D.75776, D.81908 and as further modified by Commission Resolution

F-616 dated October 1, 1986. If Debt Securities are sold by means of competitive bidding, the following procedures will be observed:

1. PG&E will contact, by telephone or otherwise, a selected group of prospective bidders to invite the submission of bids for the purchase of the Debt Securities at such time and place as may be specified by PG&E;
2. PG&E does not intend to publish a public invitation for bids or to take any action to notify any other prospective bidders, although it will respond to requests for information and permit others to submit bids if they so choose; and
3. Bids may be submitted to PG&E by telephone or otherwise.

The types of Debt Securities PG&E may issue are generally described below:

A. Secured Debt Offerings (Bonds)

The Bonds, as part of the Debt Securities requested in the application, will be issued in conformity with the provisions of, and secured by, PG&E's First and Refunding Mortgage, dated December 1, 1920, as amended (to be referred to as the Mortgage).

B. Unsecured Debt Offerings (Notes)

The Debt Securities, if in the form of unsecured debentures or notes, collectively referred to as Notes, may be issued in accordance with an indenture that would set forth the aggregate principal amount, maturity, default and other material provisions of the Notes.

The Notes may be sold in public or private offerings, with fixed or floating rates, in senior or subordinated form.

Notes may be sold in underwritten offerings, or on a best-efforts basis, or agency basis as described in the application concerning a program of Notes issued on a continuing or periodic basis.

Notes may be sold privately or publicly. A public offering in the United States will require registration under the federal securities laws by the filing of a registration statement that includes a prospectus describing the Notes. Also, Notes may be sold in domestic or European offerings.

C. Convertible Notes

One or more series of Notes may also be issued in convertible form. These Notes would be convertible into shares of PG&E's common stock. Therefore, PG&E requests authority to issue shares of its common stock. PG&E will affect any necessary registration of common stock under federal securities laws which may be required before PG&E can deliver the common stock upon conversion of the Notes.

D. Notes with Warrants

PG&E indicates that the Debt Securities may also be issued as Notes with attached warrants. One type of warrant entitles the bearer to purchase an additional Note during a period no longer than the nonredemption period for the original Note.

A second type of warrant, called an "equity warrant", would entitle the bearer to purchase shares of PG&E's common stock at a price per share to be set at the time of the offering. PG&E

will affect any necessary registration of the common stock under federal securities laws which may be required before PG&E can deliver the common stock upon exercise of the warrants.

E. Medium-Term Notes

Medium-Term Notes (MTNs) are Notes offered on a continuous or periodic basis pursuant to a shelf registration statement filed with the Securities and Exchange Commission. Maturities generally range from nine months to 15 years, although they can extend as far as 30 years. They are sold in public or private offerings, with fixed or floating rates, in senior or subordinated form.

F. Debt Securities Issued in Foreign-Denominated Currency

PG&E believes that opportunities for additional interest rate savings may exist through issuing Debt Securities denominated in the currency of a foreign country. Exposure to fluctuations in the value of the dollar, in relation to the debt obligation in the foreign-denominated currency, would be minimized by one, or more, forward contracts to purchase the currency or an independent exchange of payment obligations with another party in a dollar-denominated currency.

The CACD recommends that PG&E be placed on notice that the Commission, in order to protect the ratepayers from currency value fluctuations, will review the reasonableness of the effective interest rate for any Debt Securities issued in a foreign-denominated currency at the time of issuance and if such an

interest rate is determined to be reasonable, may, for ratemaking purposes, use that rate as the maximum embedded cost of money for such securities. The CACD also recommends that the Commission indicate that the initial interest rate which is determined to be reasonable for such securities will only be the maximum cost of money it will allow in future rate proceedings and that any reductions in the effective cost of money, resulting from currency value fluctuations, be passed on to ratepayers in future rate proceedings as a reduction in the cost of money for all debt securities in PG&E's capital structure. We adopt both the recommendations of the CACD.

G. Tax-Exempt Financings of Certain Qualified Facilities

Additionally, as part of the \$1,000,000,000 authorization sought in its application, PG&E requests authority to issue and sell the Authorities one or more series of Debt Securities or, in the alternative, to unconditionally guarantee, or otherwise secure, the Authorities' obligations in respect of their issuances of debt in connection with the financing of PG&E's Qualified Facilities.

The proposed financings with the Authorities may be structured as follows:

1. The Authority would issue and sell one or more series of its bonds, notes, debentures or other securities (Authority Bonds) plus accrued interest, to a group of underwriters who would ultimately market the Authority Bonds to the general public. Concurrently with the sale and delivery of the Authority Bonds, PG&E would enter into a loan agreement, or other security agreement, with the Authority.

2. Concurrently with the sale and delivery of the Authority Bonds, PG&E would issue and deliver to the Authority, in consideration of the Authority's obligations under the loan agreement, or other security agreement, entered into with the Authority, its Debt Securities plus accrued interest (the terms and conditions of such indebtedness to be substantially consistent with the terms and conditions of the Authority Bonds) or would unconditionally guarantee, or otherwise secure, the Authority's obligations in respect of the Authority Bonds.

The Authority Bonds could be issued in the form of long-term fixed rate tax-exempt securities. However, under certain market conditions, PG&E believes that it may be advantageous to issue one, or more, series of the Authority Bonds in the form of floating rate short-term demand bonds, commercial paper, notes or some other variable interest rate tax-exempt debt instrument. PG&E anticipates that such a variable rate financing could be structured substantially with such changes as market conditions might dictate as follows:

- a. Authority Bonds could be nominally long-term instruments but could carry a short-term interest rate because of the existence of a periodic "put" option or mandatory refunding date;
- b. The holders of the Authority Bonds would have the right to require that the Authority Bonds be redeemed, or purchased, on certain periodic dates, generally at 100% of the principal amount plus accrued interest;
- c. A Remarketing Agent would then remarket those Authority Bonds which had been redeemed, or purchased, and because the interest rate on the Authority Bonds would be periodically

reset, any redeemed, or purchased, Authority Bonds could generally be remarketed at about their full principal amount;

- d. PG&E would have the option at a certain time, or times, to change from a floating rate to a fixed rate for the remaining term of the Authority Bond; and
- e. As an additional obligation under the loan agreement, PG&E could cause to be delivered an irrevocable letter of credit, or other credit support facility, to the trustee of the Authority Bonds which would permit drawings by the Trustee for the payment of unpaid principal and accrued interest on the Authority Bonds.

Interest Rate Swaps

PG&E hereby seeks, in the alternative, either (i) that the Commission concur with PG&E that PG&E's entering into one or more interest rate swap agreements from time to time does not require Commission authorization under PU Code Sections 816 through 830; or (ii) that the Commission grant PG&E authority to enter into such agreements under PU Code Sections 816 through 830.

A. Description of Interest Rate Swaps

An interest rate swap is a contractual agreement between two parties to exchange payments that are based on .1s2 specified interest rates and a stated notional amount. Typically, interest rate swaps are arranged between one party which has a need for a fixed rate security, but because of particular circumstances can only issue floating rate debt at favorable terms, and another party which is able to issue a fixed rate security and can achieve cost savings by swapping its fixed rate security for the floating rate security's obligation.

Interest rate swaps were created to take advantage of arbitrage opportunities in the various fixed and floating rate capital markets. Arbitrage opportunities exist because some markets react to change more rapidly than others, because credit perceptions differ from market to market, and because receptivity to specific debt structures differs from market to market.

B. Interest Rate Swaps Background

Since its origination in the Eurobond market in 1981, the interest rate swap market has expanded rapidly and PG&E informs the CACD that swaps now exceed \$313,000,000,000 worldwide. At the end of 1986, financial institutions acted as counterparties for 60% of all swaps, government agencies 11%, and corporations 29%. The result of this expansion is a swap market possessing depth and liquidity. PG&E indicates that swaps now range in size from \$500,000 to \$500,000,000, run from six months to 15 years, and contain floating rate indices of LIBOR (London Interbank Offering Rate), treasury bills, commercial paper, and the prime rate of various banks. Through the development of a liquid secondary market, swaps can now be assigned or terminated.

C. Interest Rate Swaps May Be Financially Advantageous

Through the use of interest rate swaps, PG&E believes that it can reduce its issuance of commercial paper, obtain floating rate Debt Securities at less than its all-in cost of issuing commercial paper and eliminate associated liquidity risk. All in cost equals stated interest rate plus issuance and liquidity support costs. For example, PG&E may issue fixed rate

Debt Securities and swap the fixed-rate payments into floating-rate payments tied to a commercial paper index that might result in an all-in cost to the company below PG&E's all-in cost of issuing its own commercial paper. This synthetic commercial paper would typically have a maturity of longer than one year. The liquidity risk associated with commercial paper is alleged to be eliminated for the term of the swap.

Interest rate swaps can also be used to obtain long-term fixed-rate debt. On occasion, PG&E could issue floating-rate Debt Securities and swap the floating-rate payments into fixed-rate payments at an all-in cost to the company that is less than the cost of a fixed-rate Debt Security with the same term.

PG&E believes that interest rate swaps provide PG&E with another tool to manage its Debt Securities, may on occasion reduce the all-in cost of floating and fixed-rate Debt Securities and eliminate the liquidity risk associated with commercial paper.

D. Commission Authorization

In order for the Commission to have jurisdiction over interest rate swaps specifically as securities, swaps must meet certain definitions in the PU Code: either "bonds, notes" or "other evidences of indebtedness" under PU Code Section 818, or "obligations[s] or liabilit[ies] as guarantor, endorser, surety, or otherwise in respect of the securities of any other person, firm, or corporation..." under PU Code Section 830.

PG&E is of the opinion that neither of these code sections is applicable to interest rate swaps.

First, PG&E contends that interest rate swaps are not "evidences of indebtedness" under PU Code Section 818. An interest rate swap is simply an agreement between two parties to exchange periodic interest payments on a specified principal amount for a fixed period of time. Unlike a currency swap, there is not an exchange of any principal amount of "indebtedness". Also, under PU Code Section 830, PG&E alleges that an interest rate swap does not involve a guarantee of the underlying debt obligations of the other party. A party's obligation to its lenders does not change when the party enters into a swap agreement; that party is still liable to the lender for timely payment of interest and principal as specified in the loan agreement. Conversely, a party has no liability with respect to the other party's payment obligation to the other party's lenders. No reference is made in the swap agreement to any separate obligations of the parties to pay others with the funds the parties are contracting to receive under the swap agreement. Neither of the parties need even to have an obligation to pay another, interest at a certain rate; a party may contract for a certain periodic payment for some other reasons.

Another reason that PG&E believes that the Commission need not authorize interest rate swaps under PU Code Sections 816 through 830 is that such agreements are not treated as Debt Securities or guarantees under generally accepted accounting principles. The effect of interest rate swaps are merely shown on

an entity's income statement as items of income or expenses; they are not shown on its balance sheet as liabilities.

Finally, if interest rate swaps are treated as Debt Securities or guarantees by the Commission, PG&E believes the dollar amount of authorization requested in this application should be increased. If PG&E issues Debt Securities and swaps the interest payment obligations, the dollar amount of Commission authority used for the transaction is unclear to PG&E. If the dollar amount of the Debt Security and the equal notional amount of the swap each are considered to be Debt Securities, PG&E believes that the dollar amount of Commission authority needed for the transaction should be doubled.

PG&E alleges an interest rate swap is not an "evidence of indebtedness" or a "guarantee" of another's securities under PU Code Sections 818 or 830, no Commission authority is required for PG&E to enter into interest rate swap agreements under those sections.

CACD Analysis of Interest Rate Swaps

CACD has met with PG&E and other utilities on several occasions and has reviewed a variety of documentation on interest rate swaps. The CACD disagrees with PG&E that swaps are not a security. They are clearly enforceable contracts for the payment of money in exchange of a right or obligation between two parties. The swaps are simply a "second tier" contract to the underlying financial instrument issued by both parties. Further, the primary purpose of swaps would be to contract for an exchange of interest

rates by PG&E for an extended period well in excess of 12 months. Contracts for money whether in a "primary" or "secondary" tier are still of valid concern to the Commission. Regardless of PU Code sections 816 through 830, the Commission should exercise its authority through its broader powers under PU sections 701 and 703.

PG&E has described the swap process so as to make the ratepayer appear to be at least in different if not better off. However, the fact is that under PG&E's proposal, the ratepayer is simply excluded from any benefits of swaps, as proposed by PG&E, without the compensating relief of any other risks or liabilities.

One significant use of swaps is as a hedging device against interest rate changes. Hedging is a form of protection against change where, for some market-priced fee, a slightly higher price is paid for protection against dramatic unfavorable market price changes. In commercial paper, this risk is rising rates for the borrower when notes must be "rolled-over".

PG&E is immune from the need to hedge by the rate setting mechanisms currently used by this Commission. PG&E is compensated in rates for various items such as fuel oil inventories at the published 90-day commercial paper rate as reported in the Federal Reserve Bulletin. Rates are set to reflect these levels regardless of PG&E's actual cost of borrowing and PG&E is not obligated to justify the rate or attempt to mitigate that rate with attendant risks of loss of opportunities for profit.

Interest rate swaps could relieve PG&E of at least two costs associated with commercial paper: firstly, the transaction costs, estimated by PG&E to be about 5 basis points; and secondly, requirements for liquidity support, lines of credit necessary to sustain short-term borrowing, which PG&E estimates at about another 20 basis points. Thus, when PG&E issues commercial paper at 7.00%, it's all-in costs amount to approximately 7.25%. PG&E is compensated, at least partially, for these costs in its base rates set in general rate proceedings. PG&E in fact profits or loses regularly to the extent that the ratemaking Federal Reserve rate plus base rate allowances for other costs exceeds, or is smaller than, PG&E's actual rate plus actual costs.

The CACD notes that the Commission's usage of the Federal Reserve Board 90-day interest rate is intended to be a fair and reasonable benchmark of costs to be allowable in rates. Attendant is the slight opportunity for profit or loss through the careful financial management practices of the utility compared to the market as a whole. Accordingly, the CACD recommends that interest rate swaps be provisionally authorized within the following parameters and their equity and effectiveness be evaluated in conjunction with PG&E's next application for finance authority.

The CACD believes that the ratepayers should benefit from any cost savings which are realized by PG&E from interest rate swaps for expenses which were previously authorized in base rates. PG&E recovers in its general rate case base rates an

allowance for the fees charged by banks for lines of credit necessary to support its short term debt issues. Interest rate swaps will reduce PG&E's requirement for such credit support.

The CACD recommends that PG&E be required to maintain a memorandum account which will estimate the weighted average cost of PG&E's lines of credit applicable to a balance equal to the principal amount of interest rate swap securities. In the PG&E's next general rate case, PG&E should be required to make a substantial showing justifying its lines of credit costs. The Division of Ratepayer Advocates (DRA) should critically examine this memorandum account with a view to recommending the appropriate level of refund to ratepayers. Such refund would be based upon the actual or the reasonably necessary lines of credit after any interest rate swaps and the base rate allowance for these costs in PG&E's last general rate case. These costs are not normally adjusted in Attrition proceedings. The CACD further recommends that PG&E should not enter into interest rate swaps for a value greater than 80% of the items currently given rate recovery based upon the Federal Reserve Board 90-day interest rate and that the balancing accounts and memorandum accounts be excluded from this balance. These latter items are more volatile and subject to regulatory change than are fuel oil inventories, etc.

1. Limited Amount

Swaps should not exceed 80% of the authorized value at December 31, 1987 of all utility related items excluding balancing accounts and memorandum accounts accorded Federal Reserve Board 90-day interest rate treatment.

2 Reports

- a) Within 15 days of entering into a swap agreement, PG&E shall furnish to the CACD a report analyzing the swap including all costs associated with the swap in comparison to a projection of "all-in cost without a swap.
- b) Within 15 days of entering into a swap agreement PG&E shall provide the CACD with a complete copy of the executed agreement and all attendant documentation.
- c) PG&E shall separately report all interest income and/or expenses arising from all swap in all monthly and annual financial reports to Commission.
- d) PG&E shall provide copies of the accounting entries made in the memorandum account to the CACD on a quarterly basis.

3. Limit on Rate Recovery

- a) Any interest rate swap transaction which results in an increase in embedded debt cost shall not be recognized for ratemaking purposes. PG&E shall not record any cost increases on the swap memorandum account so as to "net" against any cost savings.
- b) If PG&E elects to terminate the swap before the original maturity or the swap partner terminates the swap all costs associated with the termination shall be borne by PG&E stockholders.
- c) PG&E shall place into a memorandum account all of the costs associated with the underlying liquidity supports or lines of credit equal to the value of the swap agreement. This amount is to be offset against subsequent base rate changes in general rate or Attrition proceedings and refunded to ratepayers based upon the DRA review of actual and reasonable levels of lines of credit.

- d) Regardless of the interest rate specified in the swap agreement PG&E will continue to receive recovery only at the Federal Reserve Board's 90-day interest rate plus the other adopted costs in rates after reduction for (c) above.

4. Limits on Type of Swaps

- a) All swaps shall be denominated in US dollars with no other associated hedging devices.
- b) Swaps shall be restricted to an exchange of PG&E's medium or long-term obligation.

The Commission has considered the CACD recommendations, above and finding them reasonable, will adopt them as stated above.
Request for Exemption and Other Modifications from the Commission's Competitive Bidding Rule

PG&E seeks authority to issue and sell its Debt Securities on a negotiated basis and requests an exemption and other modifications from the Commission's Competitive Bidding Rule, as modified by Resolution F-616 dated October 1, 1986 in which the Commission sets forth other provisions which exempt debt issues for which competitive bidding is not viable or available. PG&E requests additional modifications in the following areas:

- a. For negotiated public offerings for issues of \$300,000,000 principal amount or greater;
- b. For issuance of Notes on a continuous or periodic basis pursuant to a shelf registration statement and marketed on an agency basis similar to PG&E's existing commercial paper program;
- c. For interest rate swaps, if the Commission determines that interest rate swaps are Debt Securities, and the issuance of Debt Securities in connection with interest rate swaps;

- d. For the elimination of the one-day notice period contemplated in Resolution F-616; and
- e. For Debt Securities issued in 1988, as a result of market volatility.

1. \$300,000,000 Principal Amount

Under Resolution F-616, the Commission may grant exemptions from the Competitive Bidding Rule for debt issues in excess of \$200,000,000 upon a compelling showing by a utility that because of the size of the issue an exemption is warranted. PG&E asserts that compelling circumstances exist for an exemption for debt issues of \$300,000,000 principal amount, or larger, and believes that the exemption would afford it the flexibility to meet PG&E's financial requirements on the most favorable terms available. Therefore, PG&E requests an exemption from the Competitive Bidding Rule for negotiated public offerings of \$300,000,000 principal amount or greater.

PG&E believes that the size of a debt offering can determine whether a competitive bid, or a negotiated basis will produce the lowest cost. In a negotiated offering, an underwriting syndicate can be formed that consists of virtually the entire investment banking community. Because competitive bidding divides the community into several competing bidding syndicates, each syndicate has fewer participants. As a result, each participant must agree to underwrite a larger portion of the debt issue and thereby increase its risk. For small debt issues this may not result in a higher cost, but for large debt issues, the participants may require a premium to take on the greater risk.

PG&E states in its application that its statistics suggest that, while the capital markets can accommodate competitive bidding for debt issues larger than \$300,000,000, these issues are infrequent and generally restricted to companies that have high credit ratings. As a result, PG&E argues that competitive bidding for issues of \$3,000,000, or larger, may result in a higher cost of funds. PG&E notes in the application that few companies have used the competitive bidding process for debt transactions of \$300,000,000, or greater. The CACD notes that is consistent with recent decisions and concurs with this exemption.

2. Medium-Term Note Program (MTN)

Under Resolution F-616, the Competitive Bidding Rule is not applicable to debt issues for which competitive bidding is not viable or available. PG&E's MTN program would be marketed like PG&E's existing commercial paper program, through a group of dealers on a best-efforts or agency basis that is incompatible with the Competitive Bidding Rule. Therefore, PG&E requests an exemption from the Competitive Bidding Rule for the issuance of Notes on a continuous or periodic basis through dealers on a best efforts or agency basis. The CACD concurs with exempting the MTN.

3. Debt Securities Issued in Connection with Interest Rate Swaps

Under Resolution F-616, the Competitive Bidding Rule is not applicable to debt issues for which competitive bidding is not viable or available. PG&E requests that (1) interest rate swap agreements, and (2) Debt Securities issued in connection with

interest rate swap agreements be exempt from the Competitive Bidding Rule.

While it may be possible for PG&E to solicit bids for interest rate swaps or for Debt Securities to be issued in connection with interest rate swaps, the existing market does not readily operate in that manner. Interest rate swaps are opportunistic transactions that are not always available. Thus, the company must be able to respond quickly to take advantage of the opportunity.

Similarly, PG&E must be able to issue Debt Securities in connection with interest rate swaps when a lower interest rate can be obtained than would otherwise be available. In order to arrive at a lower overall cost than PG&E otherwise could obtain, the Debt Security and the interest rate swap need to be priced as one transaction. The timing and the terms of the Debt Security and the interest rate swap must match and one transaction cannot proceed without the other.

Therefore, PG&E requests an exemption from the Competitive Bidding Rule for interest rate swap agreements. The CACD concurs.

4. One-Day Notice Period

For Debt Securities sold under the Competitive Bidding Rule, PG&E seeks authority to eliminate the one-day notice requirement contained in Resolution F-616. Through the use of the Securities and Exchange Commission's shelf registration procedures, it is possible to price an offering at any time the market conditions appear favorable. Therefore, it is desirable to

be able to contact the prospective bidders and adjust the terms of the offering up to the last moment. The adjustments in the size or terms of the offering might come on the day of the pricing in response to the market conditions. The prospective bidders can adequately respond to the adjusted terms without having a 24-hour period to consider the change.

5. Exemption During 1988 as a Result of Market Volatility

Under Resolution F-616, the Commission may grant exemptions from the Competitive Bidding Rule for debt issues for which competitive bidding is not viable or available. The CACD has reviewed PG&E's request and its reasons for further modifications of the Competitive Bidding Rule, as modified by Resolution F-616. The study for F-616 showed little net difference between competitive bid and negotiated placement. In that light the CACD believes that the added benefit of auditable factual comparative data in support of competitive bids provides some intangible ratepayer safeguards.

The CACD has reviewed the Commission's Competitive Bidding Rule, and in particular, Resolution F-616 and has concluded that PG&E has not made a compelling showing or otherwise offered any substantial reasons why it should be granted a blanket exemption for all debt securities to be issued during 1988. The CACD recommends that PG&E's request for such exemptions should be denied. We agree with the CACD recommendation. PG&E has not made a compelling showing that exemptions from the Competitive Bidding Rule are warranted for Debt Securities issued during 1988 as a result of market volatility.

We place PG&E on notice that if it chooses to issue and sell the company's Debt Securities by means of negotiated private placements, or negotiated public offerings where approved by this decision, the reasonableness of the resulting interest rate and cost of money to the company will be closely scrutinized in PG&E's next general rate proceeding. This 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 30 days after issuance of PG&E's Debt Securities.

General Order Series 24 Modification

Since the MTN program is designed for continuous or periodic sales, strict compliance with General Order Series 24 could required daily filings with the Commission. Accordingly, PG&E requests authorization to be relieved of the necessity of complying with the Commission's General Order Series 24 for sales of Debt Securities under the MTN Program. In lieu of a report or reports under the general order, PG&E proposes to file, with the Commission, on or before the 25th day of the month following each quarter, a statement for the preceding quarter showing the aggregate principal amount, interest rate, maturity and cost to the company of Debt Securities sold in connection with MTN programs. This proposal is consistent with the reports currently requested by the Commission for PG&E's current shelf registration program for common stock, Dividend Reinvestment and

Common Stock Purchase Plan and Savings Fund Plan.

The CACD has reviewed PG&E's request and its reasons for exemption of the MTN Program from General Order Series 24's reporting requirements. The CACD has determined that PG&E has made a compelling showing that relief from the necessity of complying with General Order Series 24 for sales of Debt Securities under the MTN Program is warranted. The CACD recommends that PG&E be relieved of the necessity of complying with the Commission's General Order Series 24 for sales of Debt Securities under the MTN Program. The CACD concurs that PG&E file with the Commission on or before the 25th day of the month following each quarter a statement for the preceding quarter showing the aggregate principal amount, the interest rate, maturity and cost to the company of Debt Securities sold in connection with the MTN Program. We will accept the CACD's recommendation.

Use of Proceeds

PG&E proposes to use the proceeds from the sale of the Debt Securities, as requested in the application, other than accrued interest and after payment and discharge of obligations incurred for expenses incident to the issuance and sale for the following purposes:

- a. For the acquisition of property;
- b. For the construction, completion, extension or improvement of its facilities;
- c. For the improvement or maintenance of its services;
- d. For the discharge or lawful refunding of its obligations;

- e. For the reorganization or readjustment of its indebtedness or capitalization upon merger, consolidation, or other reorganization;
- f. For the possible redemption or purchase if economic, and retirement of a portion of its outstanding debt or preferred stock to partially reimburse PG&E for monies actually expended from income or other monies in its treasury not secured by or obtained from the issue of stocks, stock certificates or other evidences of interest or ownership, or bonds, notes or other evidences of indebtedness for the purposes mentioned above except maintenance of service and replacements;
- g. For future capital additions and improvements for its Qualified Facilities; and
- h. For such other purposes as are described in PU Code Section 817. The amounts so reimbursed will become a part of PG&E's general treasury funds

PG&E proposes to use a portion of such general treasury funds to repay a portion of its short-term borrowings outstanding at the time of PG&E's receipt of these proceeds.

Findings of Fact

1. PG&E, a California corporation, operates as a public utility subject to the jurisdiction of this Commission.
2. PG&E has need for external funds for the purposes set forth in the application.
3. The proposed Debt Securities and Common Stock will be used for proper purposes.
4. The proposed agreement requiring PG&E to provide security for the Authority Bonds would not be adverse to the public interest.
5. The money, property, or labor to be procured, or paid for, by the proposed Debt Securities and Common Stock is reasonably required for the purposes specified in the application.
6. The use of interest rate swaps is reasonable within the limitations proposed by CACD.
7. Exempting PG&E from Commission's Competitive Bidding Rule in the application would be adverse to the public interest, except for the limited instances discussed for interest rate swaps, issues over \$300 million and the medium term note program.
8. It is proper to determine the reasonableness of the effective interest rate incurred for any Debt Security issued in a foreign-denominated currency and to use that rate, for ratemaking purposes, as the maximum embedded cost of money in future rate proceedings.
9. It is proper for ratemaking purposes that any reduction in the effective cost of money resulting from currency value fluctuation on Debt Securities issued in foreign-denominated currency be passed on to the ratepayers in future rate proceedings as a reduction in the cost of money for all Debt Securities.

10. The Commission does not, by this decision, determine that PG&E's construction budget is necessary or reasonable for ratemaking purposes. These issues are normally tested in general rate or rate base offset proceedings.

11. There is no known opposition to this proceeding 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 that follows.

The proposed Debt Securities and Common Stock are for lawful purposes and the money, property, or labor to be obtained by them is required for these purposes. Proceeds from the security issues may not be charged to operating expenses or income.

In issuing our order, we place PG&E and its stockholders on notice that the number of shares outstanding, the total book value of these shares, and the dividends paid do not determine the allowable return on plant investment. This authorization is not a finding of the value of PG&E's stock or property, nor does it indicate the amounts to be included in rate setting proceedings.

Taking into consideration the fee exemption allowed by . . . PU Code Section 1904(b), as a result of credits from prior outstanding indebtedness and preferred stock refundings, as shown in Exhibit D attached to the application, no fees are due or payable with respect to the proposed issuance and sale of the \$1,000,000,000 aggregate principal amount of PG&E's Debt Securities.

The following order should be effective on the date of signature, to enable PG&E to proceed with its financings expeditiously. No fee is due or payable under PU Code Section 1904(b).

O R D E R

IT IS ORDERED that:

1. Pacific Gas and Electric Company (PG&E), on or after the effective date of this order and on or before December 31, 1989, is authorized to do the following:

- a. To issue, sell, and deliver in one or more series its Debt Securities and/or to unconditionally guarantee or otherwise secure the obligations of the Authorities in respect of the tax-exempt financing of PG&E's Qualified Facilities with all such issues and sales of the Debt Securities and/or unconditional guarantees being upon terms and conditions substantially consistent with those set forth in or contemplated by the application and not to exceed an aggregate principal amount of \$1,000,000,000;
- b. To issue, sell, and deliver such Debt Securities under the Commission's Competitive Bidding Rule with exemptions therefrom for the issuance of Notes on a continuous or periodic basis through dealers on a best-efforts or agency basis, for Debt Securities issued in connection with interest rate swaps.
- c. Common Stock in exchange for and upon retirement of Debt Securities issued, as set forth in the application, upon conversion of the Debt Securities and in exchange for equity warrants, as may be required from time to time;
- d. To be relieved of the necessity of complying with the Commission's General Order Series 24 for the issuance of Medium-Term Notes;
- e. To use the net proceeds from the sale of securities (exclusive of accrued interest which would be used for general corporate purposes) for the purposes described in the application;
- f. To use any accrued interest received in connection with the issue or issues of Debt Securities for general corporate purposes; and
- g. To enter into one or more interest rate swap agreements from time to time without the necessity for prior consent from the Commission

subject to the restrictions stated in the body of this opinion.

2. Promptly after PG&E ascertains (a) the price, interest rate, and other terms pertaining to the Debt Securities; (b) the amount of Common Stock that may be issued upon the conversion of Debt Securities or the exercise of equity warrants and (c) the conversion or warrant price and applicable ratio, the company shall notify the Commission in writing.

3. For the Debt Securities sold by competitive bidding, PG&E shall file a written report with the CACD showing, for each bid received, the name of the bidder, the price, interest rate, and cost to the company based on the price and interest rate within 5 business days.

4. If the Debt Securities are sold in a public offering, PG&E shall file, with the CACD, three copies of its final prospectus pertaining to the Debt Securities as soon as it is available.

5. PG&E, within 30 days after the issuance and sale of its Debt Securities by private placement, or negotiated public offerings, for use in interest rate swaps shall file a report, with the CACD, setting forth the reason the company believes the resulting interest rate and cost of money were advantageous to the company and its ratepayers.

6. PG&E shall file copies of all interest rate swap agreements and other swap related reports as described in this decision.

7. PG&E shall file the reports required by General Order Series 24 except as noted above.

8. PG&E shall submit an original and four copies of the reports required by ordering paragraphs 2 through 6 to the CACD with a transmittal letter stating the application and decision numbers. Parties need not be served with copies of the reports unless they request such service in writing. When service is made on parties who request copies of the report, PG&E shall attach to its report a certificate showing service by mail upon all those requesting copies. The Director of CACD shall send the original and one copy to the Docket Office for filing.

9. The requirement to file periodic reports shall lapse on June 30, 1990.

10. Taking into consideration the fee exemption allowed by PU Code Section 1904(b), as a result of credits from prior outstanding indebtedness and preferred stock refundings, as shown in Exhibit D attached to the application, no fees are due or payable with respect to the proposed issuance and sale of the \$1,000,000,000 aggregate principal amount of PG&E's Debt Securities.

11. The application is granted as set forth above.

This order is effective today.

Dated APR 27 1988 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 Weissert
Victor Weissert, Executive Director
AB