

CACD/BVC

Decision 91-12-057 December 18, 1991

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of PACIFIC GAS AND ELECTRIC)
COMPANY to provide up to \$500,000,000)
in capital support to regulated and)
unregulated subsidiaries or affiliates.)
(U39M)

ORIGINAL
Application 91-05-058
(Filed May 31, 1991)

O P I N I O N

Summary of Decision

This decision grants Pacific Gas and Electric Company (PG&E) the authority requested in Application (A.) 91-05-058 (application).

PG&E requests authority under Public Utilities Code (PU Code) §701 to provide up to a limit of \$500,000,000 in capital support to PG&E's regulated and unregulated subsidiaries or affiliates.

Notice of the filing of the application appeared on the Commission's Daily Calendar of June 4, 1991. 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. PG&E also provides a small amount of incidental water and steam services.

For the 12 months ended March 31, 1991, PG&E reported total operating revenues of \$9,318,934,000 and net operating income of \$1,658,694,000 as shown on Exhibit A attached to the application.

Also shown as part of Exhibit A is PG&E's Balance Sheet as of March 31, 1991, summarized as follows:

<u>Assets</u>	<u>Amount</u>
Net Utility Plant	\$16,992,310,000
Gas Stored Underground - Noncurrent	44,041,000
Other Property and Investments	920,382,000
Current and Accrued Assets	2,587,994,000
Deferred Debts	<u>1,150,053,000</u>
Total	\$21,694,780,000
 <u>Liabilities and Equity</u>	
Common Equity	\$ 7,387,829,000
Preferred Stock	1,109,647,000
Long-Term Debt	7,734,269,000
Other Non-Current Liabilities	274,137,000
Current and Accrued Liabilities	2,243,559,000
Deferred Credits	<u>2,945,339,000</u>
Total	\$21,694,780,000

Proposed Capital Support

PG&E seeks authority to provide, in one or more transactions, limited long-term capital support to PG&E's regulated and unregulated subsidiaries and affiliates. The total capital support provided shall not exceed the aggregate principal amount of \$500,000,000 at any one time.

One means by which PG&E proposes to provide capital support to its subsidiaries and affiliates is by executing one or more capital infusion agreements, under which PG&E would commit to infuse a specified amount of capital into a subsidiary or affiliate upon the subsidiary's or affiliate's request. The capital infusion agreement may then be assigned to a lender providing financing to or a letter of credit on behalf of the subsidiary.

PG&E also proposes to provide one or more letters of undertaking to insurance companies or other sureties in order to induce the insurance company or surety to issue a surety bond or indemnity bond on behalf of a regulated or unregulated subsidiary

or affiliate. PG&E states that the amount of the surety or indemnity bond would be aggregated with any other capital support provided pursuant to this application for purposes of the \$500,000,000 limit. PG&E notes that insurance companies or sureties often request such undertakings in connection with a subsidiary's or affiliate's normal business, and that a bond is frequently required to be provided in connection with gas drilling operations or in connection with the provision of insurance to the subsidiary or affiliate. Such a bond may only be made available or may be offered at a lower price if the subsidiary or affiliate can provide an undertaking by its parent that the parent will indemnify the insurance company or surety, or will provide a letter of credit to secure the obligation at the insurance company's or surety's request.

Like the capital infusion agreement, the letter of undertaking allows PG&E to assist its subsidiary or affiliate in obtaining surety bonds or insurance without actually contributing cash up front to finance the bond or insurance arrangement. It also ensures that the subsidiary or affiliate can obtain the bond or insurance at commercially reasonable rates.

Finally, PG&E seeks authorization to enter into other capital support instruments or agreements with a financial effect which is substantially similar to that of the transactions outlined above.

Discussion

PG&E states that it has in the past executed capital infusion agreements similar to the type proposed in the application, but with a term of one year or less. However, many of the projects in which its subsidiaries and affiliates invest, such as power generation projects, require substantially more than one year to complete. PG&E believes that the flexibility to provide such commitments on a multi-year basis would enable it to

withhold its equity contribution to subsidiary and affiliate projects until the time such contribution is actually required by the financing documents. For most generation projects, this time would be when the project has successfully completed its pre-operational testing phase. PG&E believes that this would provide it with significant additional control over its subsidiaries' and affiliates' project financings.

Richard A. Metzler and Associates (RM&A), a management consulting firm retained by the Commission to audit the relationship between PG&E and its unregulated subsidiary, PG&E Enterprises, states on page 119 of its May 1991, final audit report (Audit Report) respecting this application that "RM&A believes this proposal has merit, since it would put pressure on (PG&E-Bechtel Generating Company, PG&E's power generation affiliate) to complete projects within budget, on schedule and according to specifications."

Further, the capital infusion agreement structure affords a benefit to PG&E by allowing it to defer the actual contribution of cash to the subsidiary or affiliate while providing the subsidiary or affiliate the benefit of a commitment to make such a contribution from the date of execution of the agreement. This arrangement grants PG&E more flexibility in managing its cash resources. PG&E in any case would be entitled to make such a capital contribution to a subsidiary or affiliate at any time without Commission approval; in this situation, PG&E simply seeks authorization to promise, within well-defined limits, to do in the future what it can do without authorization today.

This decision is not intended to apply to any capital support which PG&E may seek to provide on behalf of Alberta and Southern Gas Co. Ltd. and the PGT-PG&E Pipeline Expansion Project (See Pacific Gas and Electric Co., A.89-04-033, April 14, 1989).

Such long-term capital support, if any, should be the subject of a separate application.

PG&E believes that the proposed capital support does not impair its financial position. PG&E points out that, given its substantial size, the \$500,000,000 authorization requested is less than seven percent of its total shareholder equity and less than three percent of its total assets.

The Audit Report also examines the financial impact on PG&E's projected 1995 investment of \$635 million in its unregulated subsidiaries, and how a write-off of that investment would affect its total debt to total capital ratio. The Audit Report states "When plotted against S&P's guidelines for AA, A and BBB bond ratings, as shown in Exhibit VII-5, the impact is hardly noticeable even for the worst case scenario." (Audit Report, page 119).

The Audit Report concludes "As a result of the foregoing analysis, RM&A is able to conclude that, on the basis of PG&E's current and 1995-projected investment in Enterprises, PG&E's ratepayers face little exposure." PG&E states that the proposed capital support also does not signal a change in its business strategy for non-regulated activities, but merely formalizes the vehicle through which it will be accomplished. PG&E believes that the financial community, including the rating agencies, has been aware of PG&E's non-regulated plans for quite some time through its public disclosures. Thus, PG&E concludes the proposed support arrangement should have no impact on existing bond ratings.

Further, PG&E states that capital support structures such as those proposed by this application are quite common among large companies and their subsidiaries and affiliates, given that they enhance the subsidiary's or affiliate's position without requiring the parent company to advance cash in a situation where other financing alternatives may be available.

Application of §701

PG&E asserts that the proposed capital support does not constitute either "bonds, notes" or "other evidences of indebtedness" under PU Code §818, or "obligation(s) or liability(ies) as guarantor, endorser, surety or otherwise in respect of the securities of any other person, firm, or corporation . . ." under PU Code §830. Thus, neither of these code sections is applicable to the authorization requested.

First, PG&E believes that the capital support transactions are not "evidences of indebtedness" under §818. It states that neither a capital infusion agreement nor a letter of undertaking to indemnify or provide a letter of credit would constitute an investment security under accepted statute or case law^{1/}, nor, PG&E believes, would it be reflected as a liability on the balance sheet under generally accepted accounting principles.^{2/}

On its own the phrase "other evidences of indebtedness" may be broad enough to encompass the capital support arrangements contemplated in the application. However, we have stated in Re Application of Willig Freight Lines [D.82-06-080, June 15, 1982, 9 Cal. P.U.C. 2d 391 (1982)] that the Legislature intended a narrower meaning to this phrase, so that it would encompass only things "of the same general nature as notes or bonds." Simply stated, PG&E's capital support arrangements are not of the same nature as notes or bonds.

1/ See SEC v. W.J. Howey, Co., 328 U.S. 293 (1946), and Reves v. Ernst & Young, No. 88-1480 [Current] CCH Fed. Sec. L. Rep. Paragraph 94,939 (February 1, 1990).

2/ Such arrangements would, if material, be reflected as a note to PG&E's financial statements.

The capital support transactions contemplated also do not involve a guarantee of the underlying debt obligations of the subsidiary or affiliate under PU Code §830. The Commission has acknowledged, in the context of PG&E's nuclear fuel financings and those of other utilities, that the assignment of the right to payment under a contract which the parent corporation has entered into, to a lender to support financing provided by the lender to an affiliated entity, does not in itself require prior Commission authorization under PU Code §830. See Pacific Gas and Electric Co., D.87-09-056, September 23, 1987; Pacific Gas and Electric Co., D.84-08-021, August 1, 1984; Pacific Gas and Electric Co., D.92555, December 30, 1980, 5 Cal. P.U.C. 2d 194 (1980); Southern California Edison Co., D.90380, June 5, 1979; San Diego Gas & Electric Co., D.90379, June 5, 1979.

In PG&E's nuclear fuel financings, PG&E undertook certain obligations under nuclear fuel leases, and the lessor's right to payment under the leases was assigned for the benefit of lenders. The lenders in turn, relying on the capital support provided by the assignment, provided financial support to the lessor for the issuance of commercial paper. The Commission found that no prior authorization was required under §830, but at PG&E's request it approved the transaction under PU Code §701.^{3/} The transactions proposed by the application are analogous to the nuclear fuel lease financings in that they involve the assignment of an obligation of the parent (the capital infusion agreement or the letter of undertaking) in support of financing provided to an affiliate.

^{3/} Cf. Pacific Gas and Electric Co., D.88-02-022, February 10, 1988, pursuant to which PG&E changed the structure of the nuclear fuel financing transaction to involve a direct guarantee and obtained Commission approval under §830.

In Pacific Gas and Electric Co., D.82-10-046, dated October 20, 1982, we found that a lease for a computer center site which PG&E executed and which was then assigned for the benefit of the lessor's creditors did not involve indebtedness or a guarantee under PU Code §§816 through 818 or §830. This was true even though the transaction was clearly a credit support arrangement, since the lessor proposed to obtain permanent debt financing based on the creditworthiness of PG&E's lease. We came to a similar conclusion with respect to a materials distribution center lease in Pacific Gas and Electric Co., D.83-06-095, June 29, 1983, 11 Cal. P.U.C. 2d 1009 (1983), relying on the computer center slip opinion.

DRA's Comments & Recommendations

On July 5, 1991, the Division of Ratepayer Advocates (DRA), submitted comments and recommendations pursuant to Rule 42(b) of the Commission's Rules of Practice and Procedure regarding A.91-05-058.

DRA recognized the need for efficient use of PG&E's financial resources and PG&E's not being handcuffed by its current method of utilizing 1-year capital support agreements.

DRA believed that longer-term capital support agreements ". . . will undoubtedly provide PG&E with the flexibility to pursue more projects at any given time than it does presently. DRA has no objections in principle to PG&E pursuing opportunities in the unregulated arena, or to its request in this application."

DRA stated that it was concerned about the potential impact of PG&E's unregulated ventures upon its utility operations if those ventures did not produce a positive return. Therefore, DRA tempered its acceptance of PG&E's pursuits in the unregulated arena with several recommendations. DRA recommended that (1) the Commission reiterate PG&E's responsibility to its ratepayers by

noting that neither PG&E's cost of capital nor its ability to raise capital in the future should be adversely affected by its pursuit of unregulated ventures; (2) the Commission should remind PG&E that its shareholders shall bear the financial "pain" of any adverse consequences as a result of PG&E's capital support agreements; (3) PG&E should notify the Commission Advisory and Compliance Division (CACD) of its outstanding capital support agreements on a quarterly basis; and (4) the Commission should retain its authority to suspend the issuance of new capital support agreements at any time with reasonable advance notification.

We believe that DRA's comments are timely and reasonable, and, therefore, will adopt its recommendations.

Conclusions

While §701.5 of the PU Code provides that an electrical or gas utility may not undertake any indebtedness or guarantee which in turn pledges "PG&E assets or credit" for or on behalf of an unregulated subsidiary or affiliate, the legislature in the preamble to §701.5 finds and declares that it is appropriate for a public utility to use on behalf of its unregulated subsidiaries or affiliates shareholder earnings that have not been reinvested in the public utility corporation (Stats. 1987 ch. 79). While the parameters of "unreinvested shareholder earnings" have not yet been established, they would presumably include a number of items, one of which would be, in PG&E's eyes, its equity investment in its subsidiaries.

At March 31, 1991, PG&E's equity investment in its subsidiaries was approximately \$565,743,000; more than the aggregate amount of the capital support requested. Viewed in this context, PG&E's investment in its subsidiaries is not a

"utility" asset, and the commitment of any amount up to the total amount of PG&E's unreinvested shareholder earnings should not be viewed as a pledge of utility assets or credit under §701.5.

Therefore, we find that as long as the aggregate amount of capital support undertaken by PG&E pursuant to this application does not exceed the \$500,000,000 requested at any given time, such capital support would not violate the provisions of §701.5 of the PU Code.

In light of the Commission's special interest in PG&E affiliate transactions, as well as the magnitude and complexity of the capital support transactions contemplated, we find it appropriate to provide a clear indication of our position on these issues. We have assumed authority in the past over PG&E's nuclear fuel leases and interest rate swaps under PU Code §701, which gives the Commission the general power to supervise and regulate every public utility in the State and to do all things, whether specifically designated in the PU Code or in addition thereto, which are necessary and convenient in the exercise of such power and jurisdiction.^{4/} We therefore elect to exercise jurisdiction over long-term capital support arrangements as proposed in this application as a matter of public policy under PU Code §701. Clarification of the nature and extent of capital support which PG&E is authorized by us to provide will benefit both PG&E's ratepayers and its shareholders by defining the extent and limit of such capital support.

CACD has reviewed PG&E's application, DRA's comments and recommendations, and recommends that PG&E file with the Commission on or before the 25th day of the month following each

^{4/} See D.92555 [December 30, 1980 (nuclear fuel leases)], and D.88-04-063 [April 27, 1988 (interest rate swaps)].

quarter a statement for the preceding quarter showing the aggregate amount of all transactions entered into by PG&E pursuant to this decision, together with a breakdown of the total between transactions entered into on behalf of regulated and unregulated subsidiaries. We will accept CACD's recommendation. DRA also recommended that we retain our authority to suspend the issuance of new capital support agreements at any time with reasonable advance notification. We believe that this recommendation will provide the impetus for PG&E to act with a certain amount of prudence and caution in its consideration of its unregulated ventures, and the financial and capital support thereof; therefore, we will accept DRA's recommendation.

Findings of Fact

1. PG&E, a California corporation, operates as a public utility subject to the jurisdiction of this Commission.
2. The approval of the proposed capital support as set forth in the application would not be adverse to the public interest.
3. The Commission does not, by this decision, authorize or determine the appropriateness of any credit support to be provided by PG&E on behalf of Alberta and Southern Gas Co. Ltd. and the PGT-PG&E Pipeline Expansion Project.
4. DRA filed written comments and recommendations pertaining to A.91-05-058.
5. 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 proposed capital support transactions, up to the aggregate amount requested, are permissible under PU Code §701.5.

3. The proposed capital support transactions do not require Commission approval under PU Code §§818 or 830.
4. No fee is payable pursuant to §1904 of the PU Code.
5. The application should be granted to the extent set forth in the order which follows.
6. In issuing our order, we place PG&E and its shareholders on notice that PG&E shall not be entitled to have transactions pursuant to this decision taken into account in PG&E's proceedings with respect to rate base, cost of capital, capital structure or allowable return on plant investment.
7. The following order should be effective on the date of signature to enable PG&E to proceed expeditiously with its capital support agreements.

ORDER

IT IS ORDERED that;

1. Pacific Gas and Electric Company (PG&E), on or after the effective date of this order, is authorized to provide up to an aggregate limit of \$500,000,000 in capital support to PG&E's regulated and unregulated subsidiaries or affiliates upon terms and conditions substantially consistent with those set forth in or contemplated by the application.
2. PG&E shall file a written report with the Commission Advisory and Compliance Division (CACD) on or before the 25th day of the month following each quarter showing for the close of the preceding quarter the aggregate amount of all transactions outstanding pursuant to this decision, together with a breakdown of the total between transactions entered into on behalf of regulated subsidiaries or affiliates and transactions entered into on behalf of unregulated subsidiaries or affiliates.

3. The Commission retains its authority to suspend the issuance of new capital support agreements at any time.

4. The application is granted as set forth above.

The authority granted by this order to undertake capital support transactions is effective today.

Dated December 18, 1991, at San Francisco, California.

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

PATRICIA M. ECKERT
President
JOHN B. OHANIAN
DANIEL Wm. FESSLER
NORMAN D. SHUMWAY
Commissioners


NEAL J. SCHULMAN, Executive Director