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Decision No. 87474 June 21, 1977 ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of SAN DIEGO GAS & ELECTRIC COMPANY, to issue and sell not exceeding 300,000 shares of its Preference Stock (Cumulative).	Application No. 57335 (Filed May 24, 1977)

OPINION

In this application San Diego Gas & Electric Company (San Diego) requests authority to issue and sell 300,000 shares of Preference Stock (Cumulative), without par value.

San Diego is a California corporation engaged in the business of providing electric service in portions of Orange and Imperial Counties, and electric, gas and steam service in portions of San Diego County. The utility reports that its uncapitalized construction expenditures amounted to $102,353,075 as of March 31, 1977, and that the unexpended balance of its capital budget on such date was $525,041,000.

The company proposes to sell the stock to several institutional investors on a private placement basis at a price of $100 per share and an annual dividend rate of $9.125 per share. San Diego plans to use the net proceeds from the sale to retire all or a portion of its outstanding commercial paper, and to apply the balance, if any, to reimburse the treasury for capital expenditures.

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Preliminary forms of the Purchase Agreement and the Certificate of Determination of Preferences relating to the stock are attached to the application as Exhibit D, and substantially provide as follows:

(a) Optional redemption price - $113.50 per share prior to June 15, 1987; thereafter and prior to June 15, 1997 at decreasing prices ($105.02 to $100.92) per share; and thereafter at $100 per share;

(b) Nonrefundable prior to June 15, 1984 through the sale of common stock or at an effective cost of money less than that of the stock;

(c) Sinking fund and mandatory redemption of 20,000 shares per annum at $100 plus accrued dividends on June 15, 1983 and on June 15, in each year thereafter; the applicant may also, at its option, provide for the redemption of up to an additional 20,000 shares through the operation of the sinking fund in any of such years, provided that such optional redemptions shall be noncumulative and will not exceed 75,000 shares in the aggregate;

(d) Liquidation, voting and other rights to be on a parity with the applicant's outstanding series of Preference Stock (Cumulative).

San Diego has received tentative commitments from three institutional investors for the purchase of the requested 300,000 shares at $100 per share as follows:

Name	Number of Shares
The Prudential Insurance Company of America	240,000
Aetna Life & Casualty Company	50,000
Gulf Life Insurance Company	10,000
Total	300,000

As compensation for securing the commitment from the institutional purchasers, applicant expects to pay Merrill Lynch, Pierce, Fenner & Smith Incorporated and Blyth Eastman Dillon & Co. Incorporated a fee of not exceeding $150,000 for their services. The utility states that, with the assistance of the brokerage firms, it has investigated the market for its proposed preferred issue and is of the opinion that a negotiated private placement is desirable at this time under current market conditions.

A letter dated May 13, 1977, a copy of which is attached to the application as Exhibit E, from Mr. Martin L. Lyons, Vice President of Merrill Lynch, Pierce, Fenner & Smith Incorporated, discusses the reasons supporting a private placement for the proposed preference issue. Pertinent portions of that letter are as follows:

> "In connection with the marketing of your preference stock offering, we contacted nine large insurance companies beginning March 25 proposing an 8-3/4% dividend rate, 18-year average life and 25-year final maturity. On that day the Prudential turned us down and on the following three business days, seven of the other eight institutions turned us down. The ninth, Aetna, indicated an interest at the 9% level for up to $7 million of stock ......
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> "It became apparent after canvassing a large number of investors that the rate again had to be raised ....
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> "On April 21, ... spoke to you about selling a public issue of $25 preference stock in lieu of taking the private money and it was decided that with declining earnings and a pro forma coverage ratio under 1.5 times, that seeking a rating was risky and there would be a possibility of being downgraded to BBB- by S&P.
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> "SDG&E's bonds were quoted at prices which yielded over 9% during the initial test marketing period. We felt that a private placement would not be put together at a rate under the level where the bonds were quoted."

Since the beginning of 1977, San Diego has issued $100,000,000 of debt securities under authority granted by this Commission. After giving effect to such previous financing and and to the preference stock issue proposed herein, the company's pro forma capital ratios as of March 31, 1977 are as follows:

	March 31, 1977 Pro Forma
Long-term debt	52.4%
Preferred and preference stock	17.4
Common stock equity	30.2
Total	100.0%

The application refers to the company's declining common stock earnings and coverage ratios and the foregoing summary clearly indicates that one of the reasons for lower coverages is the preponderance of high-cost senior securities in the company's capital structure, particularly preferred and preference stock. The staff estimates that San Diego's after-tax coverage ratios on a pro forma basis as of March 31, 1977 will be below 2 times for interest on debt and below 1.5 times for combined coverage of interest plus preferred and preference dividends. Issues of these types of securities are therefore, for the near future, precluded.

This situation has occurred frequently over the past several years despite the company's efforts, at the staff's urging, to bolster the common stock equity ratio through sales of common stock, and notwithstanding several general rate increases, the latest of which is still in the process of consideration by the Commission. During the five years ended in 1976, San Diego sold approximately $123,000,000 of common stock, mostly at prices below book value; in this same period the company experienced unprecedented outlays of $620,000,000 for new plant to meet demands of its rapidly growing service area.

The staff has been informed that applicant plans to sell about $35,000,000 of common stock later in 1977, but in light of financing already accomplished and anticipated construction outlays exceeding $200,000,000 in 1977, the planned common stock issue will not significantly affect the capitalization, even though the preferred and preference stock ratio will decline to about 16.5%.

A financial officer of San Diego has informed the Commission staff that San Diego's objective for the past several years has been to achieve a capital structure consisting of 50% debt, 15% preferred and preference stock, and 35% common stock equity. Because of the magnitude of future financing required for the Sundesert and other projects, it is unlikely that the company will be able to attain its goal for many years.

In the present instance, San Diego's cash flow will not be burdened with the $2,000,000 of annual sinking fund payments required for this issue until 1983. Also the disproportionately high ratio of preferred and preference stock should decline slightly upon the sale of additional common stock later this year.

San Diego should be apprised that all of its planned capital outlays for the future together with related financing proposals and internal cash flows will henceforth be continuously evaluated by the staff and by the Commission. This action is prompted by continual occurrences of financial emergencies stemming from coverage problems which, in turn, are cited to support repeated requests for general rate increases.

After consideration the Commission finds that:

1. The proposed stock would be for proper purposes.
2. Applicant has need for external funds for the purposes set forth in this proceeding.
3. The proposed redemption restriction is reasonable.
4. The money, property or labor to be procured or paid for by the stock herein authorized is reasonably required for the purposes specified herein, which purposes are not, in whole or in part, reasonably chargeable to operating expenses or to income.

There is no known opposition and there is no reason not to grant the authority requested effective when San Diego has paid the prescribed fee. The Commission therefore concludes that the application should be granted. A public hearing is not necessary.

In issuing our order herein, we place applicant and its shareholders on notice that we do not regard the number of shares outstanding, the total par value of the shares nor the dividends paid as measuring the return it should be allowed to earn on its investment in plant, and that the authorization herein granted is not to be construed as a finding of value of the company's stock or properties nor as indicative of amounts to be included in proceedings for the determination of just and reasonable rates.

<u>O R D E R</u>

IT IS ORDERED that:

1. San Diego Gas & Electric Company, on or after the effective date hereof and on or before August 31, 1977, may issue and sell not exceeding 300,000 shares of its Preference Stock (Cumulative), $9.125 Series, without par value, substantially in accordance with the terms and conditions set forth in the application.

2. San Diego Gas & Electric Company shall apply the net proceeds from the sale of said stock to the purposes set forth in the application.

3. San Diego Gas & Electric Company shall file with the Commission a report, or reports, as required by General Order No. 24-B, which order, insofar as applicable, is hereby made a part of this order.

4. This order shall become effective when San Diego Gas & Electric Company has paid the fee prescribed by Section 1904.1 of the Public Utilities Code, which fee is $21,000.

Dated at San Francisco, California, this 21st day of JUNE, 1977.

William Symons Jr.
President

Vernon L. Sturgeon

Richard D. Gravelle

Commissioners

Commissioner Robert Batinovich, being necessarily absent, did not participate in the disposition of this proceeding.

PUBLIC UTILITIES COMMISSION
STATE OF CALIFORNIA
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By