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Decision No. 87961 OCT 12 1977

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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of Southern California Edison Company for an Order Authorizing it to enter into a Lease pertaining to Nuclear Fuel.	Application No. 57379 (Filed June 14, 1977)

O P I N I O N

Southern California Edison Company (Edison) requests an order from the Commission disclaiming jurisdiction over the execution and delivery of a nuclear fuel lease dated December 19, 1975 and of a proposed amended lease. Alternatively, Edison requests an order to execute and deliver the nuclear fuel lease and the proposed amended lease.

The original lease was entered into as part of a project financing scheme by which Edison leased nuclear fuel from San Onofre Fuel Company (San Onofre), a corporation established exclusively for this purpose. San Onofre is a wholly owned subsidiary of Broad Street Contract Services, Inc. (BSC), a corporation engaged with its other subsidiaries in a general leasing business. BSC is owned by a partnership composed of partners who are also partners of Goldman, Sachs & Co., (Goldman Sachs), a large investment banking and underwriting firm. Goldman Sachs is one of the most experienced companies in the area of nuclear fuel leasing and is a leader in the short-term commercial paper market.

The nuclear fuel leased to Edison is financed by San Onofre through issuance of its own commercial paper which is sold on the market by Goldman Sachs. Since San Onofre has little economic substance other than the fuel ownership, the commercial paper will be supported by a letter of credit guarantee extended by Manufacturers Hanover Trust Company and Security Pacific National Bank. Goldman

Sachs will use its best efforts to sell the commercial paper at the best rate available consistent with prudent marketing considerations. San Onofre could also arrange revolving credit borrowings to be evidenced by promissory notes. The banks in addition to receiving a security interest in the nuclear fuel owned by San Onofre, would receive assignments of rents and certain other obligations under the nuclear fuel lease as security for the letters of credit and loans outstanding under the credit agreements.

Edison would pay a rental charge for the nuclear fuel during the heat production stage of the cycle. Lease payments are composed of a burnup charge and a user charge. The burnup charge calculations are based on the actual cost of fuel consumed and the lease permits Edison complete flexibility in determining the burnup rates and the associated plutonium credits. The user charge generally covers San Onofre's financing costs which will be further explained as our review of the lease arrangements progresses in this opinion.

Edison presently has in excess of $20,000,000 of nuclear fuel subject to the original nuclear fuel lease. Prior to its execution of the original lease, Edison informed the staff of the Commission, through conferences and written communications, of the financial and other advantages of the lease arrangement contemplated at that time. Edison was advised by a letter dated December 22, 1975 that the staff took no exception to the proposal but reserved the right to review the matter further in any future rate proceeding.

Subsequent to execution and delivery of the nuclear fuel lease, Edison became aware of two decisions issued by the Commission expressly disclaiming jurisdiction over leases executed by The Pacific Telephone and Telegraph Company (TPT&T) in connection with land and a building, 1/ and with data processing equipment. 2/ The

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1/ Decision No. 83333, dated August 20, 1974 in Application No. 55095.
2/ Decision No. 85874, dated May 25, 1976 in Application No. 56467.

desirability of obtaining an order of the Commission similar to that contained in TPT&T decisions cited prompted Edison to file this application.

Edison is currently involved in negotiation of the terms and conditions of an amendment to the nuclear fuel lease. The amendment incorporates various changes which are designed to expedite the communication of information between Edison and San Onofre. The amendment is also being considered by Edison in connection with a proposed amended credit agreement between San Onofre and Manufacturers Hanover Trust Company and Security Pacific National Bank, increasing San Onofre's capability to finance the acquisition of nuclear fuel from its present $37,000,000 credit limit to $187,000,000.

Edison states that the amendment to the nuclear fuel lease does not contain terms and conditions which differ materially from the existing lease other than providing for an increase in the funding limit and adding Security Pacific National Bank as a party to the amended credit agreement. Although its approval of San Onofre's execution of the amended credit agreement is required, Edison is not a party to the amended credit agreement nor does Edison have any obligation under the amended agreement.

Unless otherwise noted in the remainder of this opinion, reference to the nuclear fuel lease includes the lease executed on December 19, 1975 and the proposed amended lease.

Pursuant to the terms of the nuclear fuel lease, Edison proposes to continue to lease all or a portion of its undivided interest in nuclear fuel requirements for Units 1, 2 and 3 at its jointly-owned San Onofre Generating Station. The nuclear fuel to be subjected to the nuclear fuel lease includes nuclear fuel in the mining, milling, conversion, enrichment, heat production, reprocessing (if and when available) and storage stages. Payment for the acquisition of nuclear fuel will be made by San Onofre or by Edison and Edison will be reimbursed by San Onofre for any payments which Edison makes. Title to the nuclear fuel will pass directly to San Onofre from the suppliers of uranium ore and will remain with San Onofre throughout the 50-year term of the nuclear fuel lease unless earlier terminated.

Edison may, upon five days notice, terminate the nuclear fuel lease at any time. San Onofre may also terminate the lease under certain circumstances which include the following:

1. If San Onofre becomes subject to certain adverse interpretations, rules, regulations or declarations with respect to its status or the conduct of its business.
2. If there is a nuclear incident of sufficient magnitude.
3. By three years notice of a desire not to continue the nuclear fuel lease for the remaining term.

Upon occurrence of any such event of termination, title to the nuclear fuel would be transferred to Edison unless San Onofre and its Assignees approved transfer of title to the nuclear fuel to a third party designated by Edison. Within 270 days, but not less than 90 days after notice of termination, Edison would be obligated to purchase the nuclear fuel from San Onofre at a purchase price equal to the sum of the net stipulated loss value of the nuclear fuel plus the expenses of San Onofre, including the unamortized cost of financing the acquisition of the nuclear fuel, both computed as of the day of purchase. Upon consummation of such purchase, all obligations of Edison under the nuclear fuel lease would terminate.

A summary of the terms of the nuclear fuel lease has been furnished to the staff by Edison and is received as Exhibit No. 1

in this proceeding. Among other things, Exhibit No. 1 indicates the following:

A. Lease payments quarterly in arrears normally will be made only when the fuel is in the reactor with associated fuel costs, including interest being accrued during the build-up phase. Payments will represent the cost of fuel consumed and related financial carrying costs.

B. Financing costs are as follows:

   a. Interest charges related to outstanding commercial paper (rated Prime-1 by Moodys) issued by San Onofre.

   b. A 1½% per annum charge on the letters of credit outstanding.

   c. On the unused portion of the lease commitment, a 1/8% per annum commitment fee on the original $37,000,000 Manufacturers Hanover Trust Company supported lease line already in effect, and 1/10% per annum commitment fee on the unused portion of the proposed $150,000,000 lease line expansion. The original $37,000,000 lease will be filled first in order to reduce the commitment fees required. All commitment fees will be waived after $157,000,000 lease balance is reached.

   d. A 1/8% per annum management fee on the amount under lease.

   e. On revolving credit borrowing, if any, 125% of the higher of (1) Security Pacific National Bank/Manufacturers Hanover Trust Company prime rates, or (2) 90/119-day commercial paper rates. This would not be applicable as long as the fuel cost could be covered by commercial paper.

Exhibit No. 1 contains hypothetical presentations showing the respective revenue requirements for a 51-month burnup, pursuant to the lease arrangement and also under the assumption that Edison owns the nuclear fuel. A summary of this material follows:

	Revenue Requirements a/	
	Lease	Ownership
Accumulated Fuel Cost - Pre-Reactor	$12,903	$12,908
In Reactor Financing Cost - Rate of Return Effect (Pre-Tax)		
Lease - 6.875% b/	1,996	
Ownership - 15.08% c/		4,381
Total Revenue Requirement	$14,899	$17,289
Present Worth, January 1, 1977 at 8.80%	$11,132	$13,008

a/ Dollars stated in thousands.

b/ Includes:
Commercial paper - 5.500%
Letters of credit - 1.250%
Management fee - .125%

c/ Pre-tax rate of return based on 8.80% return granted to Edison by Decision No. 86794, dated December 21, 1976, in Application No. 54946. San Onofre would pass to Edison any available investment tax credits relating to the leased nuclear fuel.

Among the major reasons cited for leasing nuclear fuel are the following:

I. Leasing provides "off-balance sheet financing" and allows Edison to finance the fuel exclusive of the cost of equity, thereby offering a substantial economic advantage.

II. For financial reporting purposes, the nuclear fuel lease will continue to be accounted for on Edison's books as a lease in accordance with Statement of Financial and Accounting Standards No. 13 (FASB 13) 3/ of the Financial Accounting Standards Board which represents the present position of the accounting profession with regard to the proper accounting treatment for leases. Edison currently reports all leases in a balance sheet footnote under commitments and contingencies.

III. Owning nuclear fuel may have a disadvantageous effect on Edison's cash flow because of the short-term nature of the fuel asset. Under ownership cash flow associated with depreciation (burnup) must be continually reinvested in new fuel. With rising fuel costs, this process would result in continual cash flow deficits as reinvestment will exceed burnup. With the nuclear fuel lease, cash expenditures and accounting expenses for ratemaking purposes will be in balance.

IV. Leasing nuclear fuel should reduce revenue requirements to the extent that an equity return component is not required from the customers. In addition, the customers will be charged only for what they are actually using (burnup plus financing charges) and will be charged only when they are using the fuel.

V. Nuclear fuel leasing provides new sources of capital to Edison; furthermore, by increasing the availability of capital, nuclear fuel leasing may indirectly reduce the cost of more traditional forms of financing.

3/ FASB 13 issued in November 1976 defines a lease as follows:
"A lease is defined as an agreement for conveying the right to use property, plant or equipment (land and/or appreciable assets) usually for a stated period of time. It includes agreements that, although not nominally defined as leases, meet the above definition, such as a 'heat supply contract' for nuclear fuel."

The Commission, in the TPT&T Decision No. 83333 previously cited, clearly found a lack of jurisdiction over transactions wherein a public utility is the lessee under a true lease. In the present instance Edison, through its lease payments, does not acquire an ownership interest in the nuclear fuel and such lease payments would not represent a setoff, counterclaim or credit against Edison's obligations set forth in the nuclear fuel lease. Moreover, Edison would not act as guarantor, endorser or surety with respect to the financing arrangements contemplated by San Onofre in connection with its acquisition of nuclear fuel.

The Operations Division of the Commission has reviewed the application and has no objection to the execution and delivery of the nuclear fuel lease by Edison. The Finance Division has analyzed the project financing scheme and has concluded that the lease is a true lease and is not a commitment as a guarantor of indebtedness. Even if this could be considered a fuel purchase contract because of the obligation of Edison upon a terminating event described on page 4 of this Opinion, we note that the Commission does not require prior authorization of fuel purchase contracts. The Finance Division accordingly recommends that the application be dismissed.

The Commission has considered this matter and finds that:

1. Lease payments would not be credited against Edison's obligations set forth in the nuclear fuel lease.

2. Edison would not act as a guarantor of indebtedness.

3. The nuclear fuel lease is not a bond, note, or other evidence of indebtedness.

There is no known opposition and no reason to delay issuing a decision in this proceeding. The Commission reserves the right to review the nuclear fuel lease further in any future rate proceeding. A public hearing is not necessary. On the basis of the foregoing findings we conclude that (a) the nuclear fuel lease dated December 19, 1975 and the proposed amended lease is a true lease; (b) there is no commitment by Edison as a guarantor or issuer of indebtedness under Sections 816, 817, 818, 830, and 851 of the Public Utilities Code, and (c) the application should be dismissed for lack of jurisdiction.

ORDER

IT IS ORDERED that Application No. 57379 is hereby dismissed.

The effective date of this order shall be twenty days after the date hereof.

Dated at San Francisco, California, this 12th day of OCTOBER, 1977.

Robert Batinovich
President
William Symons Jr.
Vernon L. Sturgeon
Richard D. Gravelle
Claire T. Dedrick
Commissioners