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Decision No. 91889 JUN 3 1980

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of SOUTHERN CALIFORNIA EDISON COMPANY, to issue, sell and deliver by private placement, not to exceed $100,000,000 aggregate principal amount of its First and Refunding Mortgage Bonds, Series OO, Due 1986, and to execute and deliver a Forty-Sixth Supplemental Indenture.	Application No. 59515 (Filed March 13, 1980)

David Laurence Minning, Attorney at Law, for Southern California Edison Company, applicant.
Ellen LeVine, Attorney at Law, for the Commission staff.

OPINION

I. Introduction

By Application No. 59515 filed March 13, 1980, Southern California Edison Company (Edison) seeks authority to (a) issue and sell to the Saudi Arabian Monetary Agency (SAMA) not to exceed $100,000,000 aggregate principal amount of its First and Refunding Mortgage Bonds, Series OO, Due 1986 (New Bonds); (b) exempt the proposed sale of New Bonds from the requirements of the Commission's competitive bidding rule; and (c) to execute and deliver a Forty-Sixth Supplemental Indenture.

Public hearing was held in Los Angeles on May 9, 1980, before Administrative Law Judge Patrick J. Power. Edison presented the testimony of two witnesses: Robert G. Hildreth, Jr., Managing Director of Merrill Lynch (Merrill Lynch) White Weld Capital Markets Group, and Michael L. Noel, Edison's Treasurer. Staff presented the testimony of James D. Pretti of the Financial Branch of the Revenue Requirements Division. The matter was submitted upon the filing of concurrent briefs on May 16, 1980.

II. Factual Background

In early March, 1980, Edison was considering a private placement of $100,000,000 in bonds in conjunction with its planned $200,000,000 Series NN Bond offering then scheduled for April 1, 1980, and ultimately completed on March 31. As stated by Mr. Noel:

> "We had scheduled for some time a hundred million dollar bond offering. Then it became a matter of timing.
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> "As we saw our cash position worsening, the market deteriorating, and as we always are, considering financing alternatives, when Merrill Lynch brought this proposal to us it seemed to be an appropriate time to proceed with it."

On March 10, 1980, Edison authorized Merrill Lynch to act as its agent in the proposed private placement of New Bonds with SAMA. Edison asked to have a decision in about two weeks. On March 12, 1980, Merrill Lynch made a formal proposal to SAMA on behalf of Edison.

SAMA is described as "akin to the...Federal Reserve Bank of the United States". Its investments are managed by a credit committee that includes representation from financial markets in the United States and Europe. Once a proposal has been received and reviewed by members of SAMA's staff, it is then scheduled for presentation to the credit committee. The committee meets formally to discuss proposals, generally at two-to four-week intervals.

On March 12, 1980, Merrill Lynch made a proposal to SAMA for the placement of Edison's New Bonds. The contents included a summary of the proposed terms of the bond offering, but did not include a proposed interest rate. This was consistent with SAMA's practice of basing the interest rate on the most recent financial market information available at the time that it approves the loan. Merrill Lynch asked SAMA for a reply by March 24.

A regularly scheduled meeting of the SAMA credit committee was held on March 23, and a number of proposals were considered and approved, including Edison's. On March 24, 1980, Merrill Lynch received an offer in principle from SAMA, which accepted the proposed terms and provided for a coupon interest rate of 15.10 percent. The offer was good only until the close of business on that same day and a response was necessary. Merrill Lynch recommended that Edison accept the offer. After consideration, Edison agreed, and on March 24 acceptance was relayed to SAMA. Including the management fee, the effective cost of money to Edison is 15.19 percent.

In addition to the interest rate, the material terms of the bond offering include the following:

> "The New Bonds will be subject to a mandatory sinking fund which will obligate Edison to redeem $50 million in 1984. The New Bonds shall not be otherwise redeemable unless a change in tax laws of the United States or any of its political subdivisions results in interest paid to SAMA becoming subject to withholding for income tax purposes. In that event, if Edison determines that additional payments to SAMA would be required to maintain the net payment of interest at not less than the coupon rate, then, at Edison's option, redemption at par plus accrued interest may occur.

> "If, at any time other than on a sinking fund date and prior to maturity, the Trustee under Edison's Indenture should be required by Edison or the terms of the Indenture to select bonds outstanding under the Indenture for redemption, Edison will not exercise its right to specify the New Bonds for

that purpose. This restrictive redemption provision has been included to enable the utility to secure funds at a lower interest cost than would have otherwise been possible."

III. Contentions of the Parties

Edison contends that the Commission should recognize that it has a significant ongoing need for external capital. It argues that it prudently investigated sources of financing and reasonably decided to pursue foreign capital. It claims that the interest rate was reasonable as of the date of the transaction and that there would be severe repercussions for its future ability to finance if the Commission does not authorize the transaction.

Staff contends that Edison has failed to sustain its burden of proof that the proposed transaction is in the public interest. Staff states that it was "disappointed" in the interest rate in that it did not reflect sufficient savings to justify exemption from the competitive bidding rule. Furthermore, staff points out that interest rates have steadily declined in the following weeks and that the proposed interest rate is 200 basis points higher than the current market. It dismisses Edison's concerns about the implications of denying the application, but recommends that the application be granted, provided that a ratemaking adjustment is made. The specific adjustment proposed is that an interest rate of 14.5 percent be imputed in Edison's capital structure (for this incremental $100 million of debt) in place of the actual cost of money and that the embedded cost of debt component of rate of return reflect the imputed interest rate.

IV. Discussion

There is no doubt that financial markets were unusually volatile earlier this year. We face a situation where a utility has contracted with a lender to place bonds, with the interest terms known. We are, in a real sense, part of this contractual process in that we are required by statute to approve or reject the terms. The factors we weigh go to the essence of whether the rates and conditions are fair to the utility and, equally, to its ratepayers.

This financing transaction is a private placement where the lender is one known entity in contrast to the public offering where there will be a multitude of lenders. With the private placement we know the interest terms, whereas in a public offering the interest terms are not quantified when we review the matter; the rate will be determined by the market either by competitive bidding or a negotiated placement.

Our review of Edison's proposal leaves us skeptical whether the rate was advantageous and reasonable at the time Edison agreed to SAMA's terms on March 24. We take note that after the filing of this application and after the hearing borrowing terms have improved. Essentially, we agree with the staff and think a more favorable rate could have possibly been obtained at the time Edison accepted. Market condition changes are a secondary consideration, but nonetheless an important one, as we evaluate this transaction.

While not approving this particular transaction, we trust Edison and SAMA, as well as the financial community, understand we do not mean to discourage private placement. It is just that given the conditions and terms presented we cannot find this transaction would be reasonable and in the interests of Edison's ratepayers.

<u>Findings of Fact</u>

1. While the 15.10 percent negotiated rate for the proposed placement may have been less than Edison could have obtained if it had offered $100 million of debt in the public market on March 24, that rate (for relatively short-term placement) was not as desirable and advantageous as it could have been.

2. Debt interest rates have steadily declined since the filing of this application.

Conclusions of Law

1. The terms and conditions of Edison's proposed financing with SAMA have not been demonstrated to be reasonable and as advantageous as might be obtained on behalf of Edison and its ratepayers.

2. This application should be denied.

ORDER

IT IS ORDERED that Application No. 59515 is denied.

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

Dated JUN 3 1980, at San Francisco, California.

President

Commissioners

~~I dissent.~~ ~~See~~ I will file a written ~~attached statement.~~ dissent.

John E. Bryson

Commissioner Claire T. Dedrick, being necessarily absent, did not participate in the disposition of this proceeding.

A. 59515, D. 91889

COMMISSIONER JOHN E. BRYSON, DISSENTING:

The Commission's rejection of the application of Southern California Edison Company (Edison) to enter into a private placement of $100 million in bonds with the Saudi Arabian Monetary Agency (SAMA) is based on two findings: that interest rates have declined since the application was filed and that while the negotiated rate for the proposed placement "may have been less than Edison could have obtained ... in the public market on March 24, that rate ... was not as desirable and advantageous as it could have been." I do not believe either of these findings provides a proper basis for rejection of Edison's application and my review of the record persuades me that approval of the proposed transaction would have been appropriate. I am deeply concerned that the reasoning in this decision suggests a policy which will tend to limit the availability of privately placed debt for California utilities, a result especially damaging to the smaller firms which historically have relied heavily on private placement.

The Commission relies on changes in market conditions subsequent to March 24th as a reason for disapproving the Edison proposal. In effect, the Commission is demanding a "second bite at the apple" on behalf of the utility and its ratepayers, which is not available to SAMA, the committed purchaser of Edison's debt. Such a policy is not in the interest of ratepayers. It is difficult to believe that any lender will again be willing to commit itself to a rate of interest we would consider reasonable, if there is a real risk that the transaction will subsequently be abrogated if market rates drop, but be enforced if rates remain stable or increase. The lender would at least require a premium on its interest rate to reflect the risk that the Commission might at some point reject the bid because interest rates have fallen. This is scarcely consistent with the Commission's stated intent not to discourage private placements in the future.

Moreover, the concept that the Commission should judge the reasonableness of a securities transaction based on interest rates at a later date raises the troubling question as to what that date should be. How long may the Commission defer its decision to authorize or refuse to authorize a private placement negotiated weeks or months before? Surely the date from which to review the reasonableness of a transaction can be no later than the date of hearing; otherwise, upon what evidence would we rely? And why the date of hearing; why not rather the next available date upon which a securities sale might be transacted?

I do not believe that the Commission should evaluate a transaction based on information available only after the transaction occurred. The issue we should address is whether the transaction was reasonable and prudent at the time it was agreed upon. Otherwise, lenders will be reluctant to negotiate with California utilities in the future. At a minimum, they will demand higher interest rates to reflect the higher risks involved.

The other finding upon which the Commission's decision was based appears to rely upon an expectation that private placements ought to be substantially less costly than publicly issued debt. Though conceding that cost of the private placement may have been less than Edison could have obtained on the bond market, the Commission nonetheless has decided to reject the application. This decision, moreover, was reached despite the unwillingness of the staff witness to venture an opinion that it was unreasonable or imprudent for Edison to enter into the transaction. In fact, rates at which other utility debt issues, negotiated and competitive, short- or long-term, were sold in the period immediately prior to March 24th provide no indication that the Edison transaction was unreasonable at the time.

The Commission's decision today jeopardizes a major source of funds for utilities. Financing through private placement can have substantial advantages over publicly issued debt. For small utilities, it is not always efficient to go to the bond market to raise capital because the amount of money raised would be relatively small. Even the large utilities can sometimes obtain capital through private sources that are more attractive than those on the bond market, especially when bond market conditions are turbulent.

I would limit our review to a determination of the reasonableness of the transaction on the date when it occurred. On the basis of the record developed in this case, I cannot conclude that Edison acted unreasonably.

JOHN E. BRYSON, PRESIDENT

San Francisco, California
June 3, 1980