

CACD/RHG*

Decision 95-08-043 August 11, 1995

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of
SOUTHWEST GAS CORPORATION U-905-G, to
(1) issue and sell one or more series
of Debt Securities not to exceed
\$150,000,000; (2) issue and sell one or
more series of Preferred and/or
Preference Stock not to exceed
\$50,000,000; (3) issue and sell up to
7,000,000 shares of its \$1 par value
Common Stock; and (4) enter into one or
more Interest Rate Risk Management
Contracts.

Application 91-03-010
(Petition for Modification
filed May 22, 1995)

ORIGINAL

S U P P L E M E N T A L O P I N I O N

Summary of Decision

This decision grants Southwest Gas Corporation (Southwest) the authority requested in its Petition for Modification of Decision (D.) 91-06-023 (Petition), as modified by D.92-05-016 and D.93-02-009.

Notice of the filing of the Petition appeared on the Commission's Daily Calendar of June 5, 1995. No protests have been received.

By D.91-06-023 dated June 5, 1991, in Application (A.) 91-03-010, the Commission authorized Southwest before December 31, 1992, to issue debt capital in an aggregate amount not to exceed \$150,000,000; to issue and sell, in one or more series, Preferred and/or Preference Stock by public offering or private placement in aggregate principal amount not to exceed \$50,000,000; to issue, sell and deliver up to but not exceeding 7,000,000 shares of its \$1 par value Common Stock by public or private offering or upon the exercise of conversion rights or other rights or warrants related to any other securities authorized to be issued; and to enter into Interest Rate Risk Management Contracts covering amounts up to the

A.91-03-010 CACD/RHG*

outstanding balance of its floating interest rate long-term debt obligations.

The authority granted to Southwest by D.91-06-023 was extended to December 31, 1994, by D.92-05-016 dated May 8, 1992, and further to December 31, 1995 by D.93-02-009 dated February 3, 1993.

Modification Sought

Of the original authority granted by D.91-06-023, Southwest has consumed its authority to issue up to \$150,000,000 of Debt Securities; has issued 2,134,800 shares of its \$1 par value Common Stock by public offering; and has reserved for issuance 2,200,000 shares (\$1 par value Common) in conjunction with its Employee Investment Plan (EIP), Dividend Reinvestment and Stock Purchase Plan (DRSPP) and Management Incentive Plan (MIP). The authority for Preferred and/or Preference Stock and 2,665,200 shares of Common Stock remains outstanding.

Southwest is proposing that the manner of the issuance and sale of Preferred Stock be expanded to permit the use of affiliates or business trusts (financing subsidiary) to market such securities. Marketing securities in this manner will permit Southwest to issue equity securities on a tax deductible basis.

Under such an arrangement, Southwest would establish a financing subsidiary for the sole purpose of selling preferred securities for the benefit of its utility operations. In this instance, the financing subsidiary would issue and sell preferred securities and Southwest would unconditionally guarantee or otherwise secure the financing subsidiary's payment obligations pursuant to the terms and conditions of the issuance. The proceeds from the issue of the preferred securities would then be transferred to Southwest through an intercompany loan, which would be subordinate to Southwest's other Debt Securities and on terms parallel to the terms of the preferred securities issued by the financing subsidiary.

Southwest states that such an arrangement will permit it to issue through a financing subsidiary an equity security that will be treated as a form of equity by Southwest for financial

reporting purposes, while at the same time allowing it to deduct the cost of such security for tax purposes.

Southwest believes that the use of a financing subsidiary is consistent with the provisions of the Public Utilities (PU) Code § 701.5. Permitting Southwest to secure financing in this manner will benefit its interests and that of its ratepayers.

In addition, the Petition requests for clarification and confirmation of the authority granted in D.91-06-023 to issue and sell Common Stock in conjunction with Southwest's EIP, DRSP and MIP. Southwest has interpreted the grant of authority to issue Common Stock to include issuance and sale under its investment and employee stock ownership plans.

Lastly, Southwest is requesting that the authority granted in D.91-06-023, as modified, be further modified to extend the effectiveness of the Commission's authorization through December 31, 1996.

Discussion

Southwest's proposal to use a financing subsidiary to market preferred securities is similar to a security transaction referred to as Monthly Income Preferred Securities (MIPS). MIPS have the equity features of perpetual preferred stock, together with a tax deduction and other distinct advantages (interest payment deferral and bond rating benefits) to the utility and its ratepayers.

The issuance of MIPS involves several steps:

- (1) A special purpose entity is created solely for the purpose of issuing the securities to the public.
- (2) The special purpose entity would issue the securities, partially guaranteed by the utility, to the public. The guarantee would cover any accrued and unpaid distributions declared on the securities by the special purpose entity, the redemption price of any securities called for redemption by the special purpose entity, and the liquidation value of the securities (not to exceed the assets of the special purpose entity) in the event of a liquidation of the special purpose entity.

(3) The special purpose entity would lend the proceeds to the utility. This would be accomplished by the utility's issuing subordinated debentures to the special purpose entity.

A number of companies have formed special purpose entities and issued MIPS in this fashion since these securities were introduced in the market in late 1993. In D.95-04-024, the Commission authorized Southern California Edison Company to guarantee securities issued by a special purpose entity.

PU Code § 701.5 prohibits utilities from issuing bonds, notes, guaranteeing financial transactions, or pledging utility assets for or on behalf of their subsidiaries or affiliates, but allows exceptions in some instances.

PU Code § 701.5 states:

With respect to financing arrangements which are established after January 1, 1988, no electrical, gas, or telephone corporation, whose rates are set by the commission on a cost-of-service basis, shall issue any bond, note, lien, guarantee, or indebtedness of any kind pledging the utility assets or credit for or on behalf of any subsidiary or affiliate of, or corporation holding a controlling interest in, the electrical, gas, or telephone corporation. The commission may, however, authorize an electrical, gas, or telephone corporation to issue any bond, note, lien, guarantee, or indebtedness pledging the utility assets or credits as follows: ... (c) For or on behalf of a subsidiary or affiliate if it engages in activities which support the electric, gas, or telephone corporation in its operations or service, these activities are, or will be, regulated either by the commission or a comparable federal agency, and the issuance of the bond, note, lien, guarantee, or indebtedness is specifically approved in advance by the commission.

The commission shall not approve the bond, note, lien, guarantee, or indebtedness unless the commission finds and determines that the proposed financing will benefit the interests of the utility and its ratepayers.

We believe that Southwest's Petition should be granted. We recognize Southwest's claim that the manner of the issuance and sale of preferred securities through a financing subsidiary will facilitate the issuance of equity securities on a tax deductible basis. A financing subsidiary would be created solely for the purpose of issuing securities to the public to support Southwest's natural gas utility operations or service. Southwest will have 100% ownership and control of that financing subsidiary. In addition, the activities of the financing subsidiary will be subject to federal or state securities regulation and to the regulation of this Commission through our oversight of Southwest's financing activities. The financing advantages to be realized will indeed benefit the interests of Southwest and its ratepayers. Thus this proposal meets the requirements of PU Code § 701.5(c).

Pursuant to PU Code § 701.5(c), we will approve Southwest's request to guarantee securities issued by a financing subsidiary, as described in the Petition.

We caution Southwest, however, that our finding that this arrangement will benefit both Southwest and its ratepayers does not constitute a blank check for including the resulting cost of capital in its capital structure in a later proceeding. As we do with all financial authorizations, we remind Southwest that it will be expected to demonstrate and support in a future proceeding that the specific capital costs incurred were appropriate and beneficial under the circumstances. Furthermore, we will limit ratepayers' responsibility for expenses that may arise from interest on taxes that may be assessed by the Internal Revenue Service if expected tax advantages do not materialize (back taxes), as well as any penalties or interest on penalties. Ratepayers shall not be responsible for penalties or interest on penalties. Ratepayers will be responsible for (1) back taxes, to the extent that benefits of reduced taxes were flowed through to them, and (2) interest on

ratepayer recovered back taxes, calculated at no more than the rate earned on prime, three-month commercial paper, as reported in the Federal Reserve Statistical Release, G-13.

In A.91-03-010, Southwest requested authorization to obtain equity capital by the issuance and sale of 7,000,000 shares of its \$1 par value Common Stock through one or more public offerings. The application did not specifically proposed issuance of shares to any of Southwest's investment and employee stock ownership plans. In its pro forma capital structure, Southwest however presented a transaction involving the issuance of 1,300,000 shares of Common Stock to EIP, DRSP, as authorized in D.90-06-057.

We recognize that the intent in A.91-03-010 in issuing and selling Southwest's Common Stock is purely to obtain additional equity capital and the claimed uses of proceeds are consistent with those provided under PU Code § 817. The Commission has no objection to the proposed securities issue under the Petition. We will grant Southwest's request to exercise any remaining authority to issue and sell Common Stock granted in D.91-06-023 to include issuance through its EIP, DRSP, or MIP. We remind Southwest and its common stockholders that the Commission does not regard the number of common shares outstanding or the total par value of the shares as determining Southwest's allowable return on plant investment. Our authorization is not a finding of the value of Southwest's common stock or property, nor does it indicate the amount to be included in ratemaking proceedings.

We have reviewed Southwest's request to extend its unused authority to issue equity to meet its financing requirements and have determined that the proposed extension is for proper purposes and is not adverse to the public interest. We will therefore extend the authorization granted in D.91-06-023, as modified, to December 31, 1996.

We approve Southwest's Petition in this order.

Findings of Fact

1. Southwest's proposal to use a financing subsidiary to market preferred securities and unconditionally guarantee or otherwise secure the financing subsidiary's payment obligations would be for proper purposes and could offer financial advantages to Southwest and its ratepayers.

2. Southwest will use a financing subsidiary for equity securities transactions only while a benefit to it and its customers exists.

3. Savings resulting from the difference in costs between raising capital through a financing subsidiary transaction and a traditional Preferred Stock issuance will be passed to ratepayers in the revisions of Southwest's authorized cost of capital.

4. For equity securities transactions, ratepayers should not be responsible for penalties or interest on penalties, if any. Ratepayers will be responsible for any back taxes to the extent that benefits of reduced taxes were previously flowed through to them. Ratepayers will also be responsible for interest on ratepayer recovered back taxes, calculated at the prime, three-month commercial paper rate, as reported in the Federal Reserve Statistical Release, G-13.

5. The financing subsidiary Southwest described in its Petition would be created solely for the purpose of issuing securities to the public to support Southwest's natural gas utility operations or service, would be under Southwest's ownership and control, and would engage in activities regulated by this Commission.

6. The proposed issue of Common Stock in conjunction with Southwest's EIP, DRSP and MIP would be for proper purposes. Our authorization in this instance would not be a finding of the value of Southwest's stock or property, nor would it indicate the amounts to be included in ratemaking proceedings.

7. The extension to December 31, 1996 of the authority granted in D.91-06-023, as modified, would be for proper purposes and not adverse to the public interest.

8. There is no known opposition to the proceeding and there is no reason to delay granting the authority requested.

Conclusions of Law

1. A public hearing is not necessary.
2. Pursuant to PU Code § 701.5(c), a utility may be authorized by the Commission to issue bonds, notes, guarantees, or pledge assets on behalf of a wholly owned subsidiary, provided the subsidiary supports the utility's operations or service.
3. The Petition should be granted to the extent set forth in the supplemental order that follows.
4. The following supplemental order should be effective on the date of signature.

S U P P L E M E N T A L O R D E R

IT IS ORDERED that:

1. The authority granted to Southwest Gas Corporation (Southwest) by Decision (D.) 91-06-023, as modified by D.92-05-016 and D.93-02-009, is further modified to permit Southwest to use a financing subsidiary to issue and sell preferred securities for the benefit of Southwest and unconditionally guarantee or otherwise secure the financing subsidiary's payment obligations as described in the Petition for Modification of D.91-06-023 (Petition), and under conditions consistent with our findings.
2. The authority granted to Southwest by D.91-06-023, as modified, is further modified to extend the time of authorization to December 31, 1996.
3. Southwest may issue and sell additional shares of presently authorized and unissued \$1 par value Common Stock under D.91-06-023, as modified, in conjunction with Southwest's Employee Investment Plan, Dividend Reinvestment and Stock Purchase Plan and Management Incentive Plan.
4. The Petition is granted as set forth above.

5. In all other respects, D.91-06-023, as modified, remains in full force and effect.

This supplemental order is effective today.

Dated August 11, 1995, at San Francisco, California.

DANIEL Wm. FESSLER
President

P. GREGORY CONLON

JESSIE J. KNIGHT, JR.

HENRY M. DUQUE

Commissioners

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

Wesley Franklin
Acting Executive Director