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Decision 96 06 025

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ORIGINAL

In the Matter of the Application of SOUTHWEST GAS CORPORATION U-905-G, for Authority to (a) issue one or more types of debt securities in the principal amount of up to $330,000,000, (b) to obtain new capital from its subsidiary, The Southwest Companies, in principal amount of up to $175,000,000, subject to certain repayment obligations and the refinancing thereof, if necessary, through the issuance of other debt and/or equity securities and (c) enter into one or more Interest Rate Risk Management Contracts.

Application No. 96-03-055
(Filed March 29, 1996)

OPINION

Summary of Decision

This Decision grants the authority requested by Southwest Gas Corporation (Southwest) in Application (A.) 96-03-055 (Application).

Southwest requests authority, pursuant to §§ 816, 817, 818, 821, 823 and 830 of the Public Utilities (PU) Code for the following:

1. to issue or obtain debt capital in an aggregate amount not to exceed $330,000,000, through December 31, 1998, in addition to its existing authority, through the issuance directly of one or more types of indebtedness, including without limitation, debentures, bonds, notes, bank loans, private placement, commercial paper programs, bankers' acceptances and other short-term variable rate instruments (long-term instruments tied to a short-term variable interest rate) which are or may become available in the capital markets, or indirectly through one or more governmental agencies (Debt Securities);

2. to determine the precise amount and timing of each such financing, the market in and method by which each is issued, the principal amounts and maturities, and if any, the terms of redemption, repurchase security, other security, subordination and conversion provisions, rights, warrants and the other terms and provisions and the price and interest rate (which may be fixed, adjustable, variable or set by auction or remarketing or other rate setting procedures) of the borrowings and of any securities related thereto or issuable in connection therewith in the manner set forth in the Application;

3. to obtain new capital in the principal amount of up to $175,000,000 from its wholly owned subsidiary, The Southwest Companies (Companies), to the extent received as a result of the sale of PriMerit Bank, Federal Savings Bank (PriMerit), subject to certain repayment obligations and the refinancing thereof, if necessary, through the issuance of other debt and/or equity securities;

4. to enter into one or more arrangements to manage interest rate risk associated with Southwest's outstanding debt, including without limitation, interest rate swaps, caps, floors, collars or similar interest rate management methods.

Notice of the filing of the Application appeared on the Commission's Daily Calendar of April 1, 1996. No protests have been received.

Background

Southwest, a California corporation, is a public utility under the jurisdiction of this Commission, and is primarily engaged in the business of distributing and selling natural gas in portions of San Bernardino County and Placer County. Southwest is also engaged in the intrastate transmission, sale, and distribution of natural gas as a public utility in portions of the states of Nevada and Arizona.

On January 8, 1996, Southwest and Companies announced that they had reached an agreement to sell PriMerit to Norwest

Corporation (Norwest)[1]. Companies will retain all assets and liabilities of PriMerit relating to the bank's real estate development activities, the tax assets and liabilities of the bank and certain recorded intangibles. The net book value of these assets and liabilities at February 29, 1996 is a negative $381,904. The Application states that the sale is expected to be finalized in the third quarter of 1996, following receipt of shareholder and various governmental approvals and satisfaction of other customary closing conditions.

PriMerit, originally named Nevada Savings and Loan Association, was acquired by Southwest through Companies in 1986. The initial acquisition was financed in part by Southwest's sale of $62,000,000 of long-term debt and issuance of 4,300,000 shares of Southwest's $1 par value common. The acquisition was authorized by Decision (D.) 86-11-035. As part of the authorization, Southwest was also granted authority to guarantee the securities of Companies, under the provisions of PU Code § 830, with respect to the assessable stock of PriMerit under Nevada law and Southwest's agreement with the Federal Home Loan Bank Board (FHLBB) to be bound by a net worth maintenance covenant to maintain the bank's net worth at a minimum level established by the FHLBB or successor agency.

On March 28, 1996, Southwest filed with the Commission's Docket Office a Notice of Intent to sell PriMerit pursuant to Ordering Paragraph 1(h) of D.86-11-035.

For the twelve months ended December 31, 1995, Southwest reported that it generated gas operating revenues of $563,502,000 which were derived 11 percent from operations in California, 55 percent from Arizona, and 34 percent from Nevada. Net income (gas operations segment) for the same period was reported as $2,653,603,

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1 Norwest has the option to purchase either the stock or assets of PriMerit. If the stock purchase option is exercised, the purchase price will be $175,000,000. If the asset purchase option is exercised, the purchase price will be $190,700,000. The difference is a consequence of differences in tax treatment, with the net to Companies to be substantially the same under either option.

as shown in Exhibit A to the Application. Southwest's Statement of Income for 1995 ultimately registered a net loss of $14,881,810, arising from the sale and discontinued operations of PriMerit (which produced a net loss of $17,535,413). The loss per share of common stock was $0.66. As of December 31, 1995, the average common shares outstanding was 23,166,595.

We note herein that D.86-11-035 ordered that Southwest's shareholders shall pay for and absorb any losses resulting from financial difficulties arising out of the acquisition, operation or divestiture of the bank.

Southwest's Balance Sheet as of December 31, 1995, shown as part of Exhibit A, is summarized as follows:

Assets	Amount
Net Utility Plant	$1,137,749,595
Other Property and Investments	206,586,456
Current and Accrued Assets	140,832,820
Deferred Debits	47,124,519
Total Assets	$1,532,293,390

Liabilities and Equity	Amount
Common Equity	$ 356,049,725
Preferred Stock	60,000,000
Long-Term Debt	727,944,568
Total Capitalization	$1,143,994,293
Current and Accrued Liabilities	$ 210,132,665
Deferred Credits	178,166,432
Total Capitalization, Liabilities and Deferred Credits	$1,532,293,390

Debt Securities

Southwest proposes to issue Debt Securities, which may include, without limitation, commercial paper programs, bank loans, private placement with insurance companies or other lenders, bankers' acceptances or other variable rate or fixed rate borrowing instruments which are or may become available in the capital markets, in the principal amount not to exceed $330,000,000. A general description of the Debt Securities appears on pages 10 to

12 of the Application. Other floating rate debt includes short-term variable rate instruments, which are actually long-term instruments tied to a short-term variable interest rate.

Southwest states in the Application that the debt obligations may also be issued indirectly through one or more governmental agencies and loaned to Southwest, with such loans evidenced by a financing agreement, as described in Section 8.3 of the Application. Each financing will be issued through the use of an indenture, bidding and offering document, purchase agreement, loan agreement, underwriting agreement or other documents and instruments customary for the financing method selected by Southwest.

If securities are issued under the aegis of a governmental agency (Agency), Southwest will unconditionally guarantee or otherwise secure such Agency's obligations with respect to the Agency's issuance of tax-exempt debt in connection with the financing of Southwest's facilities. Southwest anticipates using the tax-exempt option whenever its facilities qualify for tax-exempt financing under federal law and such financing is available on terms more favorable than those available for taxable financings. It is currently contemplated that such financing would require Southwest to enter into, concurrently with the sale and issuance of such securities, a loan agreement or a guarantee arrangement with the Agency regarding such securities.

Interest Rate Risk Management Contracts

Southwest requests authority to enter into one or more contracts for the purpose of managing interest rate risk. Such contracts may take a number of forms including interest rate swap agreements, interest rate cap agreements, interest rate floor agreements and interest rate collar agreements. A general description of these types of contracts is presented under Section 9.3 of the Application.

Southwest is also requesting that such authority not be considered as additional debt for purposes of calculating the amount of authorization used, since the use of such authority would not affect the amount of the underlying debt issue.

Southwest has previously received Commission authority to enter into such transactions with respect to its floating-rate debt. Southwest is requesting that such authority be applicable to both its fixed- and floating-rate debt and subject to the following restrictions and limitations:

1. Southwest will maintain and make available to the Commission Advisory and Compliance Division (CACD), within 30 days of a request, a report analyzing the swap including all costs associated with the swap in comparison to a projection of all-in cost without the swap.

2. Southwest will maintain and make available to CACD, within 30 days of a request, a complete copy of the executed agreement and all associated documentation.

3. Southwest will separately report all interest income and expenses arising from all interest rate swaps in all monthly and annual financial reports to the Commission.

4. If Southwest elects to terminate an interest rate risk management agreement before the original maturity or the other party terminates the agreement, all costs associated with the termination shall be subject to review in Southwest's next cost of capital proceeding.

5. Southwest will limit its use of interest rate risk management contracts and other derivative financial instruments issued in connection with long-term debt to those involving counterparties having credit ratings equal to or better than Southwest's.

6. Swaps and other interest rate transactions shall not exceed the outstanding amount of Southwests's floating-rate long-term debt or 20% of its total long-term debt outstanding, whichever is greater.

CACD advises us that the above proposed restrictions and limitations on Southwest's fixed- and floating-rate debt raise no questions that should dissuade us from giving favorable consideration to Southwest's request to enter into one or more contracts pertaining to managing interest rate risk. In previous decisions, the Commission has authorized interest rate swaps and other rate payment exchange contracts subject to similar restrictions. D.94-12-018 dated December 7, 1994 directed Southwest to enter into interest rate risk management contracts not to exceed its outstanding floating interest rate long-term debt securities. Pacific Gas and Electric Company, Southern California Gas Company, and Southern California Edison Company all have existing authorizations pertaining to rate payment exchanges or interest rate swap agreements connected to long-term debt financings of up to 20% of the utility's total long-term debt outstanding.

The Commission has considered CACD's recommendations and, finding them reasonable, will adopt Southwest's request as stated above.

Southwest is placed on notice by this decision that the Commission may review the reasonableness of the effective interest rates for swaps, interest rate cap, floor or collar agreements issued by Southwest in conjunction with Southwest's general rate case or other ratemaking proceedings.

Loan from Companies

Southwest also seeks authority to borrow up to $175,000,000 from Companies, which will be obtained as a result of the sale of PriMerit. The transfer of funds as a result of the sale of PriMerit will be subject to repayment in the event Companies are unable to meet their indemnification obligation to Norwest.

By letter to CACD dated April 30, 1996, Southwest confirmed that Norwest made a decision to purchase the assets of PriMerit by exercising the asset purchase option. The purchase price is $190,700,000.

Once the sale of PriMerit is completed, the proceeds of the sale of up to $175,000,000 will be made available to Southwest subject to the terms of the Reimbursement Agreement for the Purchase and Assumption Option contained in Exhibit D to the

Application. Southwest states that the transaction between Southwest and Companies is a loan or an evidence of indebtedness with the Reimbursement Agreement defining Southwest's repayment obligation. Under the terms of the Reimbursement Agreement, Southwest will have the use of the funds at no cost and will only be obligated to repay the loan or evidence of indebtedness in the event Companies are unable to meet their indemnification obligations to Norwest as described in Exhibit C to the Application. In brief, the indemnification clause provides that: from and after the closing date, Companies and PriMerit shall indemnify and hold Norwest harmless against any and all losses relating to or arising out of the retained liabilities. In no event shall Companies' or PriMerit's obligations in the aggregate exceed $175,000,000. Once Companies' indemnification obligation to Norwest has ended, Southwest's repayment obligation will also expire.

The Reimbursement Agreement provides that Southwest shall reimburse Companies for any amount which Companies are required to pay Norwest, but are unable to do so due to: the payment of a dividend or loan by Companies or PriMerit to Southwest; the sale of Companies or transfer, merger, consolidation or dissolution of Companies (other than to or with PriMerit); or the encumbrance or disposition of any of Companies' or PriMerit's assets in circumstances in which the proceeds of such sale, encumbrance or disposition are not retained by Companies or PriMerit or used by Companies or PriMerit to satisfy obligations to Norwest.

It is contemplated that the Reimbursement Agreement will be executed by Southwest at the time of the sale of PriMerit. Southwest will not be able to obtain the proceeds from the sale of PriMerit until the expiration of the statute of limitations period for the liabilities retained by Companies as a result of the sale of the bank, unless Southwest executes the Reimbursement Agreement.

The funds from Companies will be provided to Southwest interest free and will not be repaid unless Companies are unable to meet their indemnification obligations to Norwest.

Southwest contemplates that approximately $160,000,000 of the funds will be transferred to Southwest by Companies immediately following the sale. Additional amounts may be made available in the future to the extent that the proceeds of the assets retained by Companies exceed liabilities. Southwest's repayment obligation will be limited to the funds actually received from Companies, but in no event will Southwest's obligation exceed $175,000,000.

Southwest intends to apply the proceeds of the loan as a result of the sale of PriMerit for the purposes outlined in the Use of Proceeds section.

We remind Southwest that it must demonstrate and support in a future proceeding that the specific capital costs incurred were appropriate and beneficial under the circumstances.

Competitive Bidding Rule

The Competitive Bidding Rule is applicable only to utilities with bond ratings of "A" or higher (item 6 of Resolution No. F-616). Southwest's debt rating is "BBB-" as reported in the March 1996 Standard & Poor's Bond Guide. Accordingly, Southwest is exempted from the Competitive Bidding Rule in connection with this authorization.

Construction Budget

Southwest's forecasted construction expenditures for 1996 through 1998, as shown in Exhibit B, Schedule I to the Application are as follows:

	(in thousands of dollars)		
Components	1996	1997	1998
Gas Distribution Plant	$135,900	$140,500	$119,600
Transmission Plant	27,000	21,000	23,000
Total	$162,900	$161,500	$142,600

We will not make a finding in this decision on the reasonableness of Southwest's proposed construction program. Construction expenditures and the resulting plant balances in rate base are issues which are normally addressed in general rate cases.

Capital Ratios

Southwest's capital ratios as of December 31, 1995 are shown below as recorded and as adjusted to give pro forma effect to the transactions that follow:

(in thousands of dollars)

Component	Recorded		Pro Forma		
Common Equity	$ 356,050	30.2%	$ 510,650	(a)	36.1%
Preferred and Preference Equity	60,000	5.1%	100,000	(b)	7.1%
Long-Term Debt	727,945	61.6%	804,945	(c)	56.8%
Short-Term Debt	37,000	3.1%	0	(d)	0.0%
Total	$1,180,995	100.0%	$1,415,595		100.0%

Note: Pro forma amounts assume all debt and equity financings requested in this filing are completed and all scheduled retirements of existing obligations are made during 1996-1998.

(a) 8,780,206 shares at an estimated average $17.61/share which include the following:

(1) 7,408,777 unused shares at an estimated $17.63/share under authority granted in D.91-06-023 and D.93-02-008, as last amended by D.95-08-043 and D.95-08-048, respectively.

(2) 1,371,429 new shares at an estimated $17.50/share under authority granted in D.96-04-044.

(b) $40 million under the authority granted in D.91-06-023 and D.93-02-008, and as last amended by D.95-08-043 and D.95-08-048, respectively.

(c) $77 million of authorized but unused debt authority granted by Commission as follows:

(1) $169 million of authorized debt authority granted by D.94-12-018.

(2) $330 million of debt authority as requested in the Application.

(3) Less $299 million of authority anticipated to be utilized in debt refinancings.

(4) Less $123 million of net proceeds from the sale of the bank, utilized to pay down debt. The obligation to the subsidiary for an estimated $160 million ($123 million and $37 million of short-term debt) was eliminated through consolidation.

(d) Short-term debt assumed to be retired by $37 million of proceeds from the bank sale.

Capital structures are normally subject to review in cost of capital or general rate case proceedings. We will not, therefore, make a finding in this decision of the reasonableness of the projected capital ratios for ratemaking purposes.

Cash Requirements Forecast

Southwest's estimated cash requirements forecasts for 1996 through 1998 (estimated as of December 31, 1995) are summarized as follows:

Components	1996	1997	1998
	(in thousands of dollars)		
Funds used or Required for Construction Expenditures	$162,900	$161,500	$142,600
Maturities of Long-Term Debt:			
Debentures	2,500	0	0
Redemptions of Long-Term Debentures	79,000	0	0
Commercial Paper	44,000	0	0
Purchase of Northern Pipeline	24,000	0	0
Short-Term Debt at Beginning of Year to be Refinanced	37,000	88,000	80,000
Total Cash Requirements	$349,400	$249,500	$222,600
Less: Estimated Cash Available from Internal Sources	56,000	78,700	83,800
Additional New Funds Required from Outside Sources	$293,400	$170,800	$138,800

Southwest's forecasted cash requirements indicate that it would require additional funds from external financing sources amounting to $603,000,000 for 1996, 1997, and 1998.

Use of Proceeds

Southwest intends to apply the net proceeds from the issuance of additional debt and the refinancing or rollover of existing debt to: (a) acquire property; (b) construct, complete, extend or improve its facilities; (c) refund maturing debt and preferred and preference stock; (d) fund payments or redemption requirements of debt, preferred and preference stock (including any premiums required); (e) retire (through defeasance or otherwise), refinance or exchange existing preferred and preference stock and short- and long-term debt (including any premiums required); or (f) reimburse its treasury for monies expended or to be expended for expansion and betterment of its facilities.

Findings of Fact

1. Southwest, a California corporation, is a public utility subject to the jurisdiction of this Commission.

2. Southwest needs external funds for the purposes set forth in the Application.

3. The proposed issuance of Debt Securities and procuring of loan with Companies are for proper purposes and not adverse to the public interest.

4. Southwest's repayment obligation under the Reimbursement Agreement is limited to the funds actually received from Companies, and in no event will Southwest's obligation exceed $175,000,000.

5. The use of credit enhancements, interest rate caps, collars and swaps in appropriate circumstances is not adverse to the public interest.

6. The Commission does not by this decision determine that Southwest's construction budget, capital ratios, and cash requirements forecast are necessary or reasonable for ratemaking purposes. These issues are normally tested in general rate cases or other proceedings.

7. Southwest's swaps and other interest rate transactions should not exceed the outstanding amount of its floating interest rate long-term debt, or 20% of its total long-term debt outstanding, whichever is greater.

8. Limiting Southwest's swaps and other derivative financial instruments issued in connection with long-term debt to those involving counterparties having credit ratings equal to or better than Southwest's will help keep counterparty risk within acceptable bounds.

9. Southwest's California operating revenues are 11% of its total operating revenues.

10. There is no known opposition to the Application and there is no reason to delay granting the authority requested.

Conclusions of Law

1. A public hearing is not necessary.

2. The Application should be granted to the extent set forth in the order which follows.

3. The proposed financing transactions are for lawful purposes and the money, property, or labor to be obtained is required for these purposes. The proceeds may not be charged to operating expenses or income.

4. The Competitive Bidding Rule applies only to utilities with bond ratings of "A" or higher.

5. Southwest has previously paid the fee of $32,836 determined in accordance with PU Code § 1904.

O R D E R

IT IS ORDERED that:

1. Southwest Gas Corporation (Southwest), on or after the effective date of this order, is authorized to do the following upon terms and conditions substantially consistent with those set forth or contemplated in Application 96-03-055 (Application):

a. to issue or obtain debt capital in an aggregate amount not to exceed $330,000,000, in addition to its existing authority, through the issuance directly of one or more types of indebtedness, including without limitation, debentures, bonds, notes, bank loans, private placement, commercial paper programs, bankers' acceptances and other short-term variable rate instruments (long-term instruments tied to a short-term variable interest rate) which are or may become available in the capital markets, or indirectly through one or more governmental agencies (Debt Securities);

b. to determine the precise amount and timing of each such financing, the market in and method by which each is issued, the principal amounts and maturities, and if any, the terms of redemption, repurchase security, other security, subordination and conversion provisions, rights, warrants and the other terms and provisions and the price and interest rate (which may be fixed, adjustable, variable or set by auction or remarketing or other rate setting procedures) of the borrowings and of any securities related thereto or issuable in connection therewith;

c. to enter into one or more arrangements to manage interest rate risk associated with Southwest's outstanding debt, including without limitation, interest rate swaps, caps, floors, collars or similar interest rate management methods; any such interest rate caps, collars or swaps shall not be considered as additional debt for purposes of calculating the amount of authorization used.

2. Southwest may enter into interest rate risk management contracts not to exceed its outstanding floating interest rate long-term debt securities, or 20% of its total long-term debt outstanding, whichever is greater.

3. Southwest shall limit its use of interest rate risk management contracts and other derivative financial instruments issued in connection with long-term debt to those involving counterparties having credit ratings equal to or better than Southwest's.

4. Southwest shall separately report all interest income and expenses arising from interest rate risk management contracts in all monthly and annual financial reports to the Commission.

5. If Southwest elects to terminate an interest rate agreement before the original maturity or the other party terminates the agreement, all costs associated with the termination should be subject to review in Southwest's next cost of capital proceeding.

6. Southwest's issue of Debt Securities is exempted from the requirements of the Commission's Competitive Bidding Rule.

7. Southwest is authorized to execute and deliver indentures, supplemental indentures and loan agreements as contemplated in the Application.

8. Southwest may obtain a loan in the principal amount of up to $175,000,000 from its wholly owned subsidiary, The Southwest Companies, to the extent received as a result of the sale of PriMerit Bank, Federal Savings Bank, subject to certain repayment obligations and the refinancing thereof, if necessary, through the issuance of other debt or equity securities and upon terms and conditions substantially consistent with those set forth or contemplated in the Application and supplemental data to the Application.

9. Southwest shall apply the proceeds of the indebtedness authorized for the purposes specified in the Application.

10. Southwest shall maintain, and within thirty days from request, provide the Commission Advisory and Compliance Division (CACD) any or all of the following:

a. The price, interest rate and other terms pertaining to its issuance of Debt Securities.

b. Copies of the executed agreements and all associated documentation.

c. If Southwest enters into contractual agreements to induce third parties to provide credit enhancements or interest rate protections/conversions in conjunction with the issue and sale of Debt Securities, a detailed listing of the costs of the credit enhancements and a report showing why Southwest believes the enhancements were advantageous to Southwest and its ratepayers.

d. A report analyzing swaps or other interest rate transactions.

e. Copies of the loan documentation.

11. The Application is granted as set forth above.

This order is effective today.

Dated ______________________, at San Francisco, California.