ENERGY/RHG

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Decision 97-05-037 May 6, 1997

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

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 $251,000,000; (b) issue one or more series of Preferred Stock in principal amount of up to $60,000,000; (c) issue up to 6,000,000 shares of its $1 par value Common Stock; and (d) refinance previously issued short-term debt securities.	ORIGINAL Application No. 97-02-049 (Filed February 24, 1997)

OPINION

Summary of Decision

This Decision grants Southwest Gas Corporation (Southwest) the authority requested in Application (A.) 97-02-049 (Application).

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

1. to issue and sell, an aggregate principal amount not exceeding $251,000,000, debentures, notes, medium-term notes, bonds, and to enter into loans or other evidence of indebtedness which includes, without limitation, commercial paper programs, bankers' acceptances, or other short-term instruments which are or may become available in the capital markets or indirectly through governmental entities (collectively Debt Securities);

2. to issue and sell, in aggregate amount not exceeding $60,000,000, one or more series of Preferred Stock;

3. to issue and sell up to 6,000,000 shares of Southwest's $1 par value Common Stock; and

4. to refinance, refund, or replace short-term debt securities.

Notice of the filing of the Application appeared on the Commission's Daily Calendar of March 14, 1997. 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 certain portions of San Bernardino, El Dorado, Placer, and Nevada Counties, California. Southwest is also engaged in the intrastate transmission, sale, and distribution of natural gas as a public utility in certain portions of the states of Nevada and Arizona and is a natural gas company within the meaning of the Natural Gas Act, subject to the jurisdiction of the Federal Energy Regulatory Commission with respect to interstate transmission facilities and sales of natural gas for resale on its northern Nevada system.

For the twelve months ended December 31, 1996, Southwest reported that it generated gas operating revenues of $546,361,000, 9.6% of which was derived from operations in California, 56.1% from Arizona and 34.3% from Nevada. Net income from utility operations for the same period was reported as $3,919,000, as shown in Exhibit B to the Application.

Southwest's Balance Sheet as of December 31, 1996, shown as part of Exhibit B, is summarized as follows:

Assets	Amount
Net Utility Plant	$1,278,456,818
Other Property and Investments	66,175,418
Current and Accrued Assets	133,020,533
Deferred Debits	45,808,767
Total Assets	$1,523,461,536

Liabilities and Equity	Amount
Common Equity	$ 379,615,316
Preferred Securities	60,000,000
Long-Term Debt	651,947,893
Total Capitalization	$1,091,563,209
Current and Accrued Liabilities	$ 242,090,257
Deferred Credits	189,808,070
Total Capitalization, Liabilities and Deferred Credits	$1,523,461,536

Description of Debt Securities

Southwest proposes to issue and sell Debt Securities in an aggregate principal amount of up to $251,000,000, in one or more forms, as described in detail under Section 8, pages 6 to 9 of the Application, and outlined below. Southwest states that the precise amount and timing of each type of debt obligation, the market in and the method by which it will be issued and the terms and provisions, price and interest rate (which may be fixed, adjustable, variable or set by auction or remarketing or other rate setting procedures) will be determined by Southwest, depending upon its financial condition and requirements then prevailing and anticipated market conditions, including competing demands for funds, existing at the time of sale.

Southwest proposes to issue any of the following Debt Securities:

1. Bonds
2. Debentures
3. Notes
4. Loans and Private Placement Indebtedness
5. Other Floating Rate Debt

The Application states that Debt Securities may be issued as debentures, notes, bonds, loans or other evidence of indebtedness which includes, without limitation, commercial paper programs, bank loans, private placement with insurance companies or other borrowers, bankers' acceptances or other variable rate or fixed rate borrowing instruments which are or may become available in the capital markets. Other floating rate debt includes short-term variable rate instruments, which are actually long-term instruments tied to a short-term variable interest rate.

The debt obligations may be issued indirectly through one or more governmental agencies and loaned to Southwest, with such loans evidenced by a financing agreement. 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.

Southwest may also have the opportunity to issue securities under the aegis of governmental agencies (Agency) by unconditionally guaranteeing or otherwise securing 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 and/or a guarantee arrangement with the Agency regarding such securities.

Interest Rate Risk Management Contracts

Pursuant to several telephone discussions with Southwest and the Accounting and Finance Branch, Southwest confirmed that it may 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, floor, or collar agreements.

Southwest has previously received Commission authority to enter into fixed- and floating-rate debt transactions (most recently under Decision (D.) 96-06-025 dated June 6, 1996). One of the limitations prescribed by the Commission in D.96-06-025 is that swaps and other interest rate transactions should not exceed the outstanding amount of Southwest's floating rate long-term debt or 20% of its total outstanding long-term debt, whichever is greater.

Having previously stated the parameter whereby interest rate risk management contracts and other derivative financial instruments may be used, we will in this decision require the following conditions on Southwest's transactions pertaining to interest rate risk management:

1. Southwest should separately report all interest income and expense arising from all interest rate transactions in all monthly and annual financial reports to the Commission.

2. 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.

3. Swaps and other derivative financial instruments carrying potential counterparty risk which Southwest receives in connection with long-term debt must have counterparties with credit ratings equal to or better than Southwest's.

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

5. Southwest must maintain and make available within 30 days of a request a report analyzing rate payment exchange contracts including all costs associated with the transaction in comparison to a projection of all-in cost without a rate payment exchange; a copy of the executed agreement and all associated documentation.

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.

Preferred Stock

Southwest seeks authority to issue and sell up to $60,000,000 of one or more series of its Preferred Stock through one or more public offerings, private placement, or through the use of a financing subsidiary or business trust as described under Section 9, pages 10 and 11 of the Application.

Southwest may sell Preferred Stock directly by offering such shares to the public through either negotiated underwritings or private placements or indirectly through one or more financing subsidiaries. Such financing subsidiary would issue and sell Preferred Stock, and Southwest would unconditionally guarantee or otherwise secure its financing subsidiary's payment obligations pursuant to the terms and conditions of the stock issuance. The proceeds from such an issuance would then be transferred to Southwest through a financing or intercompany loan on terms parallel to the terms of the stock issued by the financing subsidiary.

What Southwest is proposing in the Application is similar to the monthly income preferred securities (MIPS) transaction. Under a MIPS financing arrangement, a form of preferred security is issue and sold privately or publicly through a special purpose entity. The special purpose entity would be a subsidiary or other affiliate of the utility and would issue securities and commit the proceeds from the issuance to the utility. Such loan arrangement would be evidenced by deferrable interest subordinated debentures to be issued by the utility.

We will grant Southwest's request to issue Preferred Stock through one or more financing subsidiaries. This Commission has granted similar authorization under PU Code § 701.5 for deferrable interest securities to Pacific Gas and Electric Company, San Diego Gas & Electric Company, Southern California Edison Company, and Southwest.

Pursuant to PU Code § 701.5(c), we will approve Southwest's request to guarantee or otherwise secure, through one or more agreements to such effect, deferrable interest securities issued by one or more financing subsidiaries.

Southwest's financing subsidiary should be created solely for the purpose of issuing securities to the public to support Southwest's operations or service. Southwest shall have 100% ownership and control of the special purpose entity. 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 its oversight of Southwest's financing activities.

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. Furthermore, we will limit ratepayers' responsibility for expenses that may arise from interest on taxes that may be assessed by the Internal Revenue Service (IRS) if expected tax advantages do not materialize (back taxes), as well as any 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.

Common Stock

Southwest proposes to issue up to 6,000,000 shares of its $1 par value Common Stock, from time to time through one or more public or private offerings as described under Section 10, pages 11 and 12 of the Application.

The Common Stock will be sold by means of a private placement, by registered underwritten public offerings, or through Southwest's previously approved dividend reinvestment/stock purchase and employee benefit plans. Such plans include Southwest's Dividend Reinvestment and Stock Purchase Plan, Employees Investment Plan, Management Incentive Plan and the 1996 Stock Incentive Plan (collectively Plans).

Southwest states that the precise number and timing of each offering and sale will be established with due regard to its financial condition, capital requirements and the prevailing and anticipated market conditions. The sale through its dividend reinvestment/stock purchase and employee benefits will also take into consideration the number of shares necessary to continue the Plans.

Southwest's proposed issue of Common Stock raises no questions that should dissuade us from giving favorable consideration to the authorization requested.

Southwest and its stockholders are placed on notice that the Commission does not regard the number of shares outstanding or the total book value of these shares as measuring the return Southwest should be permitted to earn on its investment in plant. Our authorization is not to be construed as a finding of the value of Southwest's stock or properties nor as indicative of the amounts to be included in proceedings for the determination of just and reasonable rates.

Competitive Bidding Rule

The Competitive Bidding Rule applies 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 February 1997 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 1997, 1998 and 1999, as shown in Exhibit C, Schedule I to the Application are as follows:

Components	1997	1998	1999
	(in thousands of dollars)		
Gas Distribution Plant	161,300	149,100	136,100
Transmission Plant	6,800	7,600	6,900
Total	168,100	156,700	143,000

Southwest's forecasted construction expenditures for 1997 through 1999, amounting to a total of $467,800,000, raise no questions that should dissuade us from giving favorable consideration to the financing requested in the Application. We will not, however, make a finding in this decision on the reasonableness of the 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, 1996 are shown below as recorded and as adjusted to give pro forma effect to the transactions that follow:

Component	Recorded (in thousands of dollars)		Pro Forma		
Common Equity	379,600	31.3%	549,900	(a)	33.5%
Preferred and Preference Equity	60,000	4.9%	160,000	(b)	9.8%
Long-Term Debt	651,900	53.8%	930,900	(c)	56.7%
Short-Term Debt	121,000	10.0%	0	(d)	0.0%
Total	1,212,500	100.0%	1,640,800		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 1997-1999.

(a) 8,965,000 shares at an estimated average $19.00 per share which include the following:

(1) 2,965,000 unused shares at an estimated $19.00/share under authority granted in D.91-06-023 and D.93-02-008, as last amended by D.95-08-043, D.95-08-048 and D.96-11-013, respectively.

(2) 6,000,000 new shares at an estimated $19.00 per share as requested in the Application.

(b) $100,000,000 of preferred stock as follows:

(1) $40,000,000 under the authority granted in D.93-02-008, and as last amended by D.95-08-048 and D.96-11-013, respectively.

(2) $60,000,000 of preferred stock authority as requested in the Application.

(c) $279,000,000 of debt authority as follows:

(1) $19,000,000 of authorized debt authority granted by D.94-12-018, and as last amended by D.96-11-013.

(2) $330,000,000 of debt authority as granted in D.96-06-025.

(3) $251,000,000 of authority as requested in the Application.

(4) Less $321,000,000 of authority anticipated to be utilized in debt refinancing.

(d) Short-term debt assumed to be retired by $121,000,000 of proceeds from securities issued.

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 1997 through 1999 are summarized as follows:

Components	(in thousands of dollars) 1997	1998	1999
Funds used or Required for Construction Expenditures	168,100	156,700	143,000
Maturities of Long-Term Debt: Commercial Paper	200,000		
Short-Term Debt at Beginning of Year to be Refinanced	121,000	91,300	97,600
Total Cash Requirements	489,100	248,000	240,600
Less: Estimated Cash Available from Internal Sources	87,300	89,400	94,900
Additional New Funds Required from Outside Sources	401,800	158,600	145,700

Southwest's forecasted cash requirements indicate that it would require additional funds from external financing sources amounting to $706,100,000 for 1997 through 1999.

Use of Proceeds

The proceeds from the issuance of debt and equity will be used to: (a) acquire property; (b) construct, complete, extend or improve facilities; (c) refund maturing debt and preferred stock; (d) fund payments or redemption requirements of debt and preferred 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 Southwest's treasury for monies expended or to be expended for expansion and betterment of its facilities.

PU Code § 823(d) provides:

> No note payable at a period of not more than twelve months after the date of issuance of such note shall, in whole or in part, be refunded by any issue of stocks or stock certificates or other evidence of interest or ownership, or of bonds, notes of any term or character, or any other evidence of indebtedness, without the consent of the commission.

Pursuant to PU Code §§ 818 and 823(d), we will approve Southwest's intended use of proceeds (including the refinancing, refunding, or replacement of short-term debt) from the proposed issue of equity and Debt Securities.

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 issue of Debt Securities, Preferred Stock, and Common Stock is for proper purposes and is not adverse to the public interest.

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

5. 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.

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

7. 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.

8. 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.

9. The financing subsidiary Southwest described in the Application 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.

10. 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 case proceedings.

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

12. 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 keep counterparty risk within acceptable bounds.

13. Southwest's California operating revenues are 9.6% of its total operating revenues.

14. 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 are 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. 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.

6. PU Code § 823(d) provides that no note payable at a period of not more than 12 months after the date of issuance of such note shall be refunded, in whole or in part, by any issue of stocks or stock certificates or other evidence of interest or ownership, or of bonds, notes of any term or character, or any other evidence of indebtedness, without the consent of the Commission.

7. Southwest has previously paid the fee of $16,747 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 97-02-049 (Application):

a. to issue and sell, an aggregate principal amount not exceeding $251,000,000, debentures, notes, medium-term notes, bonds, and to enter into loans or other evidence of indebtedness which includes, without limitation, commercial paper programs, bankers' acceptances, or other short-term instruments which are or may become available in the capital markets or indirectly through governmental entities (collectively Debt Securities);

b. to issue and sell, in aggregate amount not exceeding $60,000,000, one or more series of Preferred Stock;

c. to issue and sell up to 6,000,000 shares of Southwest's $1 par value Common Stock; and

d. to refinance, refund, or replace short-term debt securities.

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 shall be subject to review in Southwest's next cost of capital proceeding.

6. Southwest may use a financing subsidiary and unconditionally guarantee or otherwise secure the financing subsidiary's payment obligations as described in the Application, and under conditions consistent with our findings.

7. Southwest may refinance, refund, or replace its existing short-term debt, including such debt authorized in Decision 94-12-018, with the proceeds from the issue of debt and equity authorized in this decision.

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

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

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

11. The Application is granted as set forth above.

12. This proceeding is closed.

This order is effective today.

Dated May 6, 1997, at San Francisco, California.

P. GREGORY CONLON
President
JESSIE J. KNIGHT, JR.
HENRY M. DUQUE
JOSIAH L. NEEPER
RICHARD A. BILAS
Commissioners