

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA F-1

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to Executive Director

RESOLUTION NO. F-616

EVALUATION & COMPLIANCE  
DIVISION

DATE: October 1, 1986

R E S O L U T I O N

\_\_\_\_ Director  
\_\_\_\_ Numerical File  
\_\_\_\_ Alphabetical File  
\_\_\_\_ Accounting Officer

SUBJECT: Commission Policy Re: Competitive Bidding Rule

WHEREAS: The Commission has, from time to time, set forth its policy regarding the competitive bidding rule which was adopted in Decision (D) 38614 dated January 15, 1946, and subsequently amended by D.49941, D.75556, and D.81908. In Resolution No. F-591, dated August 4, 1981, we set forth our current policy regarding exemptions from the competitive bidding rule which is as follows:

"The Securities Unit of the Revenue Requirements (now Evaluation & Compliance) Division will review each application requesting an exemption from the Commission's competitive bidding rule. Based on the facts and circumstances of each filing, the Revenue Requirements Division shall prepare on an ex parte basis either (1) a decision granting the exemption or (2) a decision denying the exemption, but granting authority to proceed on a competitive bid basis.

"Decisions granting exemptions from the rule shall also grant authority to proceed on a competitive bid basis, so as to provide for maximum financial flexibility under the then prevailing economic conditions."

The staff of the Evaluation & Compliance Division has prepared a report on the competitive bidding rule which sets forth certain conclusions and recommendations regarding the rule. The report is attached hereto as Exhibit A. We have examined our policy in light of current economic and financial conditions and we concur with the recommendations as set forth in the report. We have determined that certain modifications are required. Our strong preference for competitive bidding remains unchanged. However, we recognize that there are certain circumstances which would justify the granting of exemptions. We find it necessary to modify our previous policy and to define those circumstances under which requests for exemption will be granted or considered.

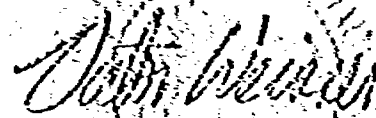
IT IS ORDERED that the policy relating to exemptions from the competitive bidding rule is modified as follows:

(1) The competitive bidding rule is mandatory for all domestic debt issues of debentures and first mortgage bonds of \$200 million or less.

- (2) Requests for exemption from the rule will only be entertained for debt issues in excess of \$200 million, and will only be granted upon a compelling showing by a utility that because of the size of the issues an exemption is warranted.
- (3) Debt issues for which competitive bidding is not viable or available are exempt.
- (4) The notification requirement to solicit bids is shortened to one day.
- (5) Telephonic competitive bidding is allowable.
- (6) The rule is only applicable to utilities with bond ratings of "A" or higher.
- (7) Bond issues of \$20 million or less are exempt.

I hereby certify that the foregoing Resolution was duly introduced, passed and adopted at a regular meeting of the Public Utilities Commission of the State of California, held on October 1, 1986, the following Commissioners voting favorable thereon:

DONALD VIAL  
President  
VICTOR CALVO  
FRASCALLA C. GREW  
FREDERICK R. DUDA  
STANLEY W. HULETT  
Commissioners



Executive Director

EXHIBIT A

CALIFORNIA PUBLIC UTILITIES COMMISSION  
EVALUATION AND COMPLIANCE DIVISION

REPORT ON THE  
CALIFORNIA PUBLIC UTILITIES COMMISSION'S  
COMPETITIVE BIDDING RULE  
FOR ISSUANCE OF DEBT SECURITIES

JAMES D. PRETTI  
Deputy Director

San Francisco, California  
September 5, 1986

At the Commission meeting of July 16, 1986, Commissioner Frederick Duda requested that the Evaluation and Compliance Division (E&C) prepare a report on the Commission's Competitive Bidding Rule for the issuance of debt securities. It was specifically requested that the report address the following questions:

1. Is the Rule which was first adopted on January 15, 1946 still applicable in light of current financial and economic conditions?
2. Is it necessary or desirable to have a Competitive Bidding Rule?
3. Should the Commission strictly enforce the present Rule, or should the Commission continue its present policy of granting exemptions on a case-by-case basis?
4. What circumstances justify granting exemptions to the Rule?

#### Background

The Competitive Bidding Rule was adopted by the Commission in Decision (D.) 38614, dated January 15, 1946, and subsequently amended by D.49941, D. 75556 and D. 81908. The Rule originally applied to all types of securities, stocks, bonds, notes and conditional sales contracts. Subsequent amendments to the Rule were adopted which resulted in the current Rule being applicable to debt securities only and to issues of \$5 million or more.

The Commission has from time-to-time reviewed the applicability of the Rule under prevailing circumstances and has granted exemptions as deemed warranted. The Commission's current policy regarding exemptions to the Competitive Bidding Rule was set forth in Resolution No. F-591, dated August 4, 1981, a copy of which is attached as Appendix A. The Resolution states that each request for exemption to the Competitive Bidding Rule will be reviewed by the Securities Unit of the Revenue Requirements Division (now E&C).

Based upon the facts and circumstances of each request, the staff will prepare an ex parte decision either granting or denying the exemption.

In preparing this report the staff solicited comments from Pacific Bell, Pacific Gas and Electric Company, San Diego Gas and Electric Company, Southern California Gas Company, Southern California Edison Company, and General Telephone Company of California, and has incorporated their responses throughout the report.

### Conclusions

It is the opinion of the E&C Division that a Competitive Bidding Rule is both applicable and desirable under current financial and economic conditions.

The Competitive Bidding Rule should be enforced for all publicly issued domestic debentures and first mortgage bonds of \$200 million or less.

Bond issues in excess of \$200 million would also be required to be issued via competitive bidding; however, requests for exemption would be considered if a utility can clearly demonstrate that because of the size of the offering, an exemption is justified.

Petitions for exemption from the Rule will only be granted upon a conclusive showing by a utility that an exemption would be in the best interest of ratepayers.

The Competitive Bidding Rule should be modified to exempt debt issues which do not lend themselves to competitive bidding.

The Rule should be modified to shorten to one day the notification requirements to solicit competitive bids and also to permit telephonic bids.

#### Discussion

Needless to state that since the Competitive Bidding Rule was adopted by the Commission in 1946, financial and economic conditions have changed radically. Therefore, the question of whether the Rule is still applicable in light of current economic conditions is quite appropriate. Except for Southern California Edison Co., all of the utilities submitting comments to the staff were unanimous in their opinion that the Rule is outdated, is no longer useful, and should be abolished. We agree that the Rule is outdated and should be modified; however, we do not agree that it is no longer applicable, nor should it be abolished.

Interest rates have decreased significantly during the past two years as has the rate of inflation. It is the opinion of the majority of financial analysts and economists that barring some unforeseen events or circumstances, there is room for further moderate reductions in interest rates in the near future, and that the current low rate of inflation will continue to be relatively stable. We believe that in such a period of declining interest rates competitive bidding can produce the lowest cost to a utility.

A major factor in considering the applicability and desirability of a Competitive Bidding Rule is the question of which method, competitive or negotiated, produces the lowest cost. It can be argued that by definition, competitive bidding results in the lowest cost. However, evidence does not support such an argument. Many studies have been conducted and many articles have been

published comparing the two methodologies. These studies and publications are remarkably unanimous in concluding that there is no clear evidence to indicate that either method produces the lowest cost.

The E&C staff analyzed all of the debt securities issued by "A"- and "AA"-rated utilities from January 1981 to July 1986. The results of that analysis are presented on Graph I, for "A"-rated utilities and Graph II, for "AA"-rated utilities. These graphs show the cost to a utility for long-term bonds (10 or more years) sold on a competitive bidding basis (dotted line) and on a negotiated basis (dashed line), together with a comparison of cost for comparable long-term Treasury issues (solid line). As can be seen in the graphs, the lines for competitive and negotiated continually cross over each other indicating that at various times each method resulted in the lowest cost. The graphs also clearly illustrate that neither method consistently results in the lowest cost. The staff also reviewed a similar analysis made by Solomon Brothers for the years 1970 to 1980. The results of that study were virtually identical to the results shown on Graphs I and II.

It could be further argued that since there is no empirical evidence that the use of either method guarantees the lowest cost, then the enforcement of a Competitive Bidding Rule under certain conditions would not result in utilities incurring higher debt costs. We believe that if the Commission were to adopt such a policy, it could do so feeling comfortable that the results would be as reasonable as could be expected. It would be proper to note at this point that Southern California Edison Co. almost exclusively

uses competitive bidding for its domestic bond issues. Although there are reasons other than competitive bidding, it should be stated that Southern California Edison Co. has the lowest embedded debt cost of any major California utility.

We will now define those certain conditions under which enforcement of a Competitive Bidding Rule would, and would not, be applicable.

Since the Rule was adopted in 1946 and revised in subsequent Commission decisions, utilities have experienced many changes in financial markets. In response to changing business and economic conditions, such markets have become more complex and financing methods more sophisticated. Financing instruments which are in common use today did not exist 20 years ago, let alone 40 years. A number of these debt securities, either by their nature or by established business practices do not lend themselves to competitive bidding. Securities privately placed with specific lenders and bank term loans obviously must be negotiated. Competitive bidding is not presently available in European or Japanese markets. Certain tax-exempt pollution control bonds have terms which are specifically negotiated. Variable interest rate debt is normally completed on a negotiated basis. It is reasonable that these types of debt instruments should be exempt from the Competitive Bidding Rule.

However, domestic issues of debentures and first-mortgage bonds still lend themselves quite nicely to competitive bidding, particularly for utilities with bond ratings of "A" and above. Bond ratings of "BBB" are considered to be the lowest investment grade of bonds; ratings below that are considered to possess speculative elements. Utilities with bond ratings of "BBB" or below should have



the flexibility to be able to issue bonds both on a competitive bidding and a negotiated basis.

The utilities have stated, and we believe with some logic, that the size of a debt offering can be determinative of whether competitive bidding or negotiated basis will produce the lowest cost. It has been stated that for a large-sized debt offering a negotiated pricing can likely produce a lower cost. In a negotiated offering, an underwriting syndicate can be formed consisting of virtually the entire investment banking industry with each participant agreeing to take a various number of bonds. In a competitive offering, the investment banking firms are divided into bidding syndicates. With fewer firms in the syndicate, participants will agree to take a greater number of bonds. Having to take a greater number of bonds, it is argued, creates greater risk for the firms and they will tend to bid more aggressively.

The staff analyzed the size of bond issues by "A"- and "AA"-rated utilities from January 1981 to June 1986. For "A"-rated utilities, 52 issues were on a competitive basis with an average size of \$75 million, and 146 issues were on a negotiated basis with an average size of \$110 million. For "AA"-rated utilities, 65 issues were on a competitive basis with an average size of \$105 million, and 78 issues were negotiated with an average size of \$130 million. Of all bonds issued on a competitive basis, 40% were in excess of \$100 million, whereas 58% of all bonds issued on a negotiated basis were in excess of \$100 million. This would indicate that the larger the size of a bond issue, the more likely utilities would opt for a negotiated offering. Based upon this

market observation it would be appropriate for the Commission to consider requests for exemption from the Rule for debt issues over \$200 million.

The utilities are unanimous in their comments that negotiated pricing affords greater flexibility in timing an issue, i.e., they can react more quickly to market events, results in greater pre-marketing efforts by investment bankers, and results in a greater number of investment bankers being available to form a selling syndicate. In regard to greater flexibility, we believe that the Rule should be modified to reduce to one day the notification requirement to solicit competitive bids and that telephonic bidding be permitted. This should provide sufficient flexibility to allow utilities to quickly react to market conditions. As to pre-marketing efforts and number of investment firms in a selling syndicate, there is no evidence to suggest lower costs will result.

The utilities allege that in times of volatile capital markets, negotiated pricing can result in lower costs. However, there is no evidence to support such an allegation. Our review of debt issues covering the past 15 years indicates that in periods of volatile capital markets, at no time did either method exhibit a clear advantage.

The present Rule exempts issues of \$5 million or less; we believe that the limitation should be increased to \$20 million. Issues of \$20 million or less are usually offered by small utilities that are not well known in the financial community. Consequently, it is difficult to generate sufficient interest among investment bankers to form bidding syndicates.

Recommendations

The Commission should enforce the Competitive Bidding Rule for all debt issues of \$200 million or less.

Requests for exemption from the Rule should only be entertained for debt issues in excess of \$200 million, and would only be granted upon a compelling showing by a utility that because of the size of the issues an exemption is warranted.

The Rule should be modified to exempt those debt issues for which competitive bidding is not viable or available. The Rule should be further modified to shorten to one day the notification requirements to solicit competitive bids and to also permit telephonic competitive bidding.

The Rule should only be applicable to utilities with bond ratings of "A", or higher.

Bond issues of \$20 million or less should be exempt from the Rule.

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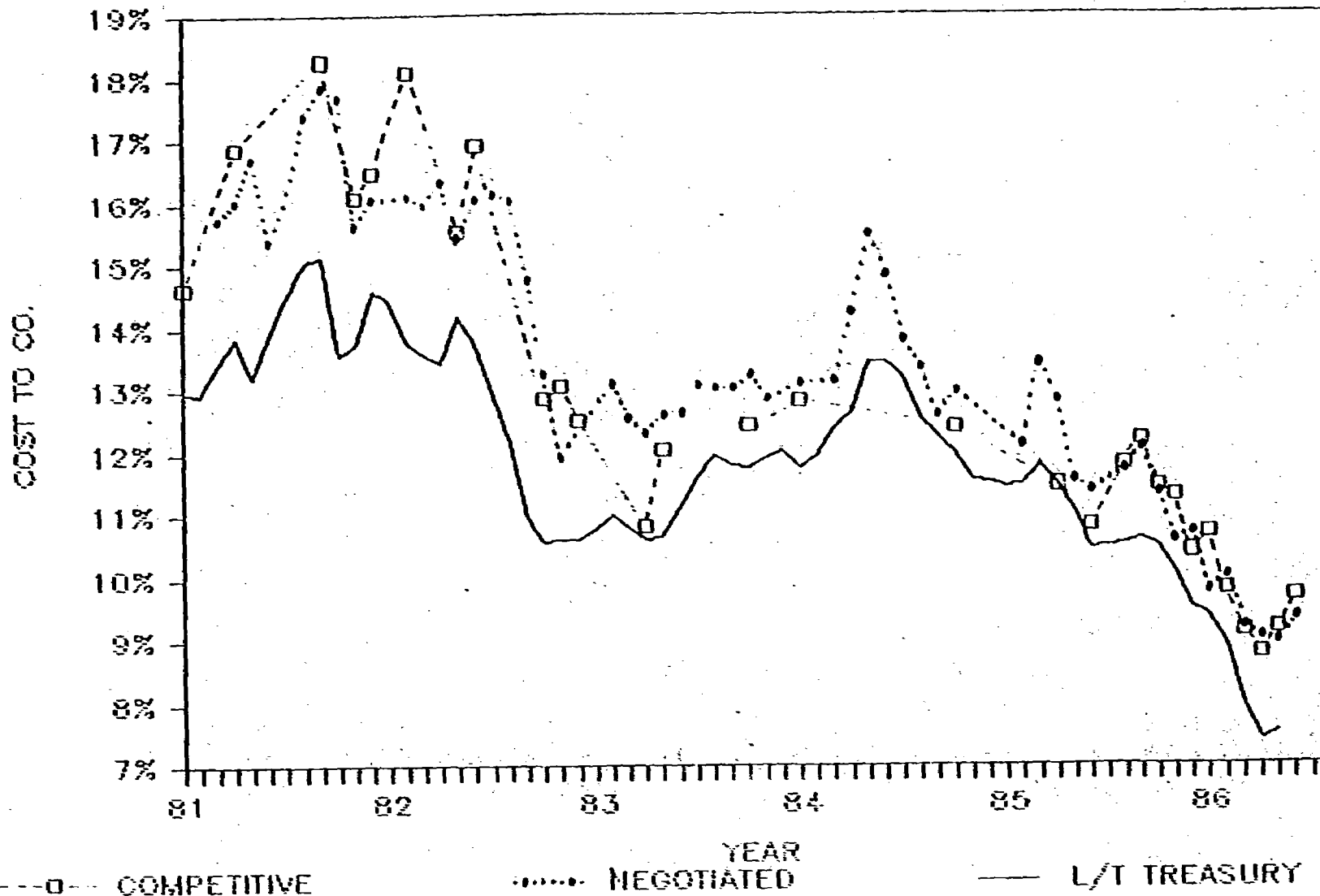
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GRAPH 1

# "A" RATED DEBT SECURITIES MAJOR UTILITIES



# "AA" RATED DEBT SECURITIES

## MAJOR UTILITIES

