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Utility Debt Applications and Competitive Bidding

Competitive Bidding versus Negotiated Bidding

The employment of Competitive Bidding for securities offerings is outdated and unnecessary; Negotiated bidding is the market standard.

Competitive bidding in the financial markets refers to a process whereby a utility solicits bids from a pre-selected group of underwriters (investment banks) for a proposed securities offering, typically with very little advance notice. The terms of the financing are dictated in advance by the utility. The underwriter providing the lowest cost of funds is awarded the transaction and is obligated to underwrite (purchase) the entire offering. The underwriter must be well capitalized to transact a multi-million dollar transaction. The underwriter then sells the security to various investors. The underwriter takes on all the sales risk. To compensate for sales risk, the price offered to the utility includes a risk premium.

For the period 2008-2010, only five out of 5,663 debt issues (across all industries) in the U.S. investment grade corporate bond market were competitively bid, which represents approximately 0.1% (both by number of deals and volume). None of the competitive bid transactions were done by the California Investor Owned Utilities ("IOUs"). The California IOUs regularly seek exemptions from the competitive bidding rule.

Negotiated bidding is a process whereby the utility selects one or more underwriters in advance of the financing transaction and works with those firms to design, structure, size and otherwise determine the optimal financing terms for a security offering. Once the security offering is announced to the open market by the underwriters, investors openly compete to purchase the utility's security, ultimately driving the price and size of the investment book. Over the past two years, the Sempra Utilities achieved record low coupon rates on their debt issuances, with the book of accounts being oversubscribed up to three times through negotiated bidding. In short, negotiated bidding has become the market standard for optimal financial flexibility, pricing, and opportunities for Diverse Business Enterprises ("DBEs") to participate as underwriters.

Competitive Bidding Rule OIR R.11-03-007 (Simon)

The Joint IOUs have proposed a new Utility Long-Term Debt Financing Rule that is based on market best practices and encourages DBE utilization.

Since March 2011, interested parties to the OIR have participated in all aspects of this proceeding (filed initial and reply comments, attended prehearing conferences and workshops, and developed a red-line of the rule). There is a general consensus among interested parties, including DBE firms, that the Competitive Bidding Rule ("CBR") is outdated and unnecessary.

At the invitation of Commissioner Simon, the California IOUs proposed a new Utility Long-Term Debt Financing Rule that is intended to replace the CBR. The proposed rule: (1) reflects current market practices and standards, (2) provides utility flexibility to take advantage of market opportunities and adjust pricing, in order to obtain low-cost debt financing, (3) allows utilities to take better advantage of market competition, and (4) facilitates utility efforts to provide DBE firms with meaningful opportunities to participate in financing transactions. Exemptions to the proposed rule were avoided.

The Utility Long-Term Debt Financing Rule would require public utilities to: (1) prudently issue debt, consistent with market standards that encompass competition and transparency; (2) determine the financing terms of their debt issues with due regard for their financial condition and requirements, as well as market conditions; (3) use their best efforts to engage Women Minority Disabled Veteran Owned Business Enterprises (WMDVBE) in being appointed as lead underwriter, co-manager, or in other roles in debt securities offerings; and (4) only use authorized debt enhancement features in conjunction with the financings outlined in utilities' long-term debt applications.

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Ratepayer interest remains a focal point of the proposed rule; it highlights the utilities' goal of achieving the lowest long-term cost of capital for ratepayers. In addition, the proposed rule requires that the appointment of WMDVBE firms be cost effective, so as not to increase financing costs to ratepayers.

The issuance of a Proposed Decision in the Competitive Bidding OIR is expected in April 2012 with a Final Decision in May 2012.

DBE Utilization - SDG&E and SoCalGas

Since 2004, SDG&E and SoCalGas, have actively sought to include DBE underwriting firms in their security offerings, employing 29 DBE firms in aggregate. For 2011, SDG&E utilized the services of five DBE firms as joint lead and co-managers for $600 million of bond offerings. Most recently, in its November 14, 2011 bond offering of $250 million, SDG&E successfully employed a DBE firm in a lead underwriter role and assigned two other DBEs to the transaction's only co-manager roles.