

Decision 03-06-011 June 5, 2003

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of SOUTHERN CALIFORNIA EDISON COMPANY U-338-E, for authority to issue, sell, and deliver one or more series of Debt Securities and to guarantee the obligations of others in respect of the issuance of Debt Securities, the total aggregate principal amount of such indebtedness and guarantees not to exceed \$1,586,840,000; to execute and deliver one or more indentures; to sell, lease, assign, mortgage, or otherwise dispose of or encumber utility property; to issue, sell and deliver in one or more series, an aggregate amount not to exceed \$250,000,000 par or stated value of Cumulative Preferred Stock \$25 Par Value, Cumulative Preferred Stock --\$100 Par Value, Preference Stock or any combination thereof and for an exemption from the Commission's Competitive Bidding Rule.

Application 00-07-006
(Petition for Modification
Filed January 25, 2001)

In the Matter of the Application of SOUTHERN CALIFORNIA EDISON COMPANY U-338-E, for an Order to issue Debt Securities, and/or Guarantee the Debt Securities of an Edison affiliate, to finance its Fuel Oil, Nuclear Fuel, and Coal Inventories in an aggregate principal amount not to exceed \$900,000,000.

Application 88-03-024
(Petition for Modification
Filed January 25, 2001)

In the Matter of the Application of SOUTHERN CALIFORNIA EDISON COMPANY U-338-E, for an order increasing the currently authorized amount of variable interest rate debt instruments, or guarantees of the debt securities of another, to finance undercollections in its Regulatory Balancing Accounts, from \$700,000,000 to an aggregate principal amount not to exceed \$1,200,000,000.

Application 00-07-048
(Petition for Modification
Filed January 25, 2001)

In the Matter of the Application of SOUTHERN CALIFORNIA EDISON COMPANY U-338-E, for Authority to issue, sell, and deliver one or more series of Debt Securities and to guarantee the obligations of others in respect of the issuance of Debt Securities, the total aggregate principal amount of such indebtedness and guarantees not to exceed \$800,000,000; to execute and deliver one or more indentures; to sell, lease, assign, mortgage, or otherwise dispose of or encumber utility property; and for an exemption from the Commission's Competitive Bidding Rule.

Application 97-11-032
(Petition for Modification
Filed January 25, 2001)

O P I N I O N

1. Summary

This decision grants the amended expedited petition filed on March 8, 2002, by Southern California Edison Company (SCE) to modify Decisions (D.) 88-07-069 and D.00-10-063. SCE is granted an exemption from the Competitive Bidding Rule.

2. Background

SCE originally filed its “Expedited Petition” for modification of D.88-07-069, D.98-02-104, D.00-10-040, and D.00-10-063 on January 25, 2001. In that petition, SCE requested, among other things, that the Competitive Bidding Rule exemptions contained in those decisions be revised to additionally include domestic underwritten public offerings of fixed interest rate bonds and debentures exceeding \$200 million in principal amount.

After requesting and receiving additional information from SCE, we issued D.02-01-061, which modified D.00-10-040 by authorizing SCE to issue \$3.5 billion of debt to finance its Procurement-Related Obligations Account (PROACT). In our decision, among other things, we granted SCE’s request for exemption from the Commission’s Competitive Bidding Rule for debt issues in excess of \$200 million.

On January 8, 2002, Administrative Law Judge (ALJ) Evans issued a ruling in these proceedings requiring SCE to submit additional information supporting its request for exemptions from the Commission’s Competitive Bidding Rule in its various applications for financing authority. SCE provided that information on January 28, 2002.

To clarify the record, SCE filed an Amended Expedited Petition on March 8, 2002 to provide information regarding the remaining amounts of financing authorization included in D.88-07-069, D.98-02-104, and D.00-10-063. SCE believes this “new” information may be useful to the Commission in considering SCE’s request for Competitive Bidding Rule exemptions.

In addition, in its Amended Expedited Petition, SCE seeks to withdraw that portion of the original petition, which asked for modification of D.00-10-040, as to the Competitive Bidding Rule, because the relief sought was included in

D.02-01-061, our PROACT decision. In its amended petition, SCE also seeks withdrawal of that portion of the original petition, which asked for modification of D.98-02-104, as to the Competitive Bidding Rule, because the remaining authorized amount under that decision is now less than the \$200 million benchmark.

On October 1, 2002, the ALJ issued another ruling requiring SCE to further update the record and to provide the Commission more information related to these proceedings, the competitive bidding process and to determine whether, and to what extent, Edison should be exempted from the Competitive Bidding Rule. We asked a series of seven (7) questions. Edison provided its response on October 17, 2002, with its latest Amended Expedited Petition.

3. SCE's Response to the October 1, 2002 Ruling

We are addressing SCE's response in its entirety since it includes a wealth of information with regard to this application and to utility financing in general. The following is SCE's detailed response to our questions as well as our seven questions:

1. Other Decisions Where SCE Requested and Received an Exemption from the Competitive Bidding Rule

SCE has received an exemption from the Competitive Bidding Rule in each of its existing financing authorization decisions where it has been requested. Thus, D.98-02-104, D.00-10-063 and D.88-07-069 include exemptions for issues of variable rate debt securities, overseas indebtedness, foreign currency denominated securities, medium term notes, commercial paper, preferred securities, tax exempt securities and for obtaining loans. The exemptions have been granted in recognition that these types of debt issues do not lend themselves to competitive bidding. SCE also received an exemption from competitive bidding in D.02-01-061, which financed PROACT.

What SCE did not seek in the above decisions was an exemption for fixed rate bonds, intermediate and long-term notes and debentures (other than tax exempt securities) sold publicly in the domestic market. This additional component, domestic underwritten public offerings of fixed interest rate bonds and debentures exceeding \$200 million in principal amount, forms the basis for SCE's present request for expanded competitive bidding relief.

2. The Competitive Bid Process vs. a Negotiated Offering Process

In a competitive bidding process, an issuer, usually after consulting with one or more investment banks, determines the amount, structure and timing of the debt offering. The issuer invites two or more lead managers to bid on the transaction. In turn, the lead managers form underwriting syndicates consisting of other investment and commercial banks, and possibly other financial institutions. There is no premarketing of the securities. At a specified time and date (determined by the issuer), the lead managers submit their bids to the issuer. The issuer awards the deal to the lowest bidder, although it retains the ability to reject all bids.

The competitive bidding process is fundamentally designed for highly rated, well-known issuers who do not require any pre-sale meetings or discussions with potential investors. These issuers are frequently in the market and the investment community knows and is comfortable with their credit profiles, performance and outlook. Investor confidence in the issuer, and consequently the debt issue itself, is essential to obtaining successful and cost-effective financing. Furthermore, the issue must be small enough to be fully sold to investors in a short period of time.

In contrast, under a negotiated offering, an issuer selects one or more underwriters for a debt offering. Usually, a lead manager is appointed with

others possibly sharing or being given various roles in the transaction (*e.g.* co-book, co-lead, or senior underwriter). The underwriting group will advise the issuer as to the appropriate structure, timing, and amount of the proposed transaction, given the issuer's credit story and current market conditions.

If necessary, the lead underwriter will arrange and schedule investor presentations in strategic locations across the country and possibly internationally. These meetings are attended by prospective investors and analysts, and involve presentations by company executives and investment bankers. Online or video investor conferences may also be used to educate investors.

After the investor presentations, an order period is initiated whereby the investment banks solicit purchase orders from investors. This period is critical in identifying investor demand at different pricing levels and therefore in setting the final price or rate on the securities. This type of market intelligence cannot be obtained through a competitive bid process.

In a negotiated offering, final pricing is determined based upon investor demand for the bonds, and is based on the lowest possible rate that will achieve the necessary transaction size. Underwriting fees for negotiated capital market transactions are generally determined according to an industry-wide standard, which is based upon the debt's maturity.

Negotiated transactions are the most commonly means used for issuing securities. They are necessary when there are potential investor concerns about the issuer and/or the financing, including such matters as credit quality, and unresolved or uncertain legislative, judicial or regulatory issues affecting the issuer. In these types of situations, the investor presentations described above

are commonly conducted to perform additional marketing and solicit investor interest in the debt offering.

SCE explains that being non-creditworthy effectively eliminates the competitive bidding option because, as noted above, that method of offering securities is limited to highly rated issuers having no or limited credit issues. On the other hand, being non-creditworthy does not affect the ability to conduct a negotiated transaction and is the means by which such issuers accomplish their financings.

The rules adopted in D.38614, as amended in Commission D.49941, 75556 and 81908 and Resolution F-616 (collectively referred to herein as the “Competitive Bidding Rule” or “Rule”) reflect a policy preference by the Commission for California public utilities to obtain competitive bids for the sale of their debt securities. However, Exhibit A to Resolution F-616, provides, “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.” Resolution F-616, by its express terms, states that the Competitive Bidding Rule is “only applicable to Utilities with bond ratings of ‘A’ or higher.” The Competitive Bidding Rule, therefore, recognizes that a non-creditworthy issuer cannot reasonably, and should not be required to, engage in competitive bidding.

3. Need to Use Current Financing Authority and For What Purposes

SCE expects to use current financing authority as early as 2003 in order to refinance outstanding debt. In 2002 and 2003, SCE has \$725 million of maturing long-term debt, none of which has been refinanced. In addition, in 2002 and 2003, SCE has \$1.3 billion of PROACT-related debt maturing which will

need to be repaid using proceeds from financing.¹ As indicated below, even if by these times it has returned to single-A credit status, SCE expects that competitive bidding will not be possible for these refinancings.

4. Impact if Exemption is not Granted

SCE explains that if it is not granted the requested exemption, the refinancings could be difficult, if not impossible to complete, if SCE is required to do them through competitive bidding. SCE could attempt a competitively bid offering, but maintains that there is no assurance that any investment banks would participate. If they did, SCE believes the banks would add a large risk premium to the pricing of the transaction in order to offset the potential risk that they would not be able to place the securities with investors. Thus, even if a competitively bid transaction were achievable, it would likely not be cost-effective. Furthermore, SCE believes that if it announces a competitive bid transaction and investment banks fail to participate, even greater investor and market anxiety over the transaction would result because of the negative perception created by the banks' failure to participate. SCE contends that if it returns to the market at a later date with the same transaction, there would already be built-in apprehension about the deal.

SCE states that another possibility is that investment banks would participate in the transaction but submit unattractive bids due to their perception of the transaction's risk. As noted above, SCE has the option to reject all bids and cancel the transaction; however, issuers rarely exercise that option due to the

¹ SCE has been using cash from PROACT recovery to retire maturing long-term debt. When this PROACT-related debt matures, SCE will need to replace it by issuing new long-term debt, effectively replacing the long-term debt that was retired during the PROACT recovery period.

negative signals it sends to the market due to uncertainty about the reasons for the rejected bid. SCE maintains that a subsequent offerings will inevitably come at higher costs, again due to investor perception of increased risk.

One last financing possibility would be for SCE to seek financing through the bank market. Since such financings tend to be for shorter terms, SCE states that it would have to seek refinancing again in the not-too-distant future. In addition, SCE believes that with the recent contraction in bank lending (due to various market factors including the downturn in the economy and stock market as well as many large corporate failures), it may be very difficult to raise sufficient funds to meet SCE's requirements through this market.

As long as SCE's bond rating remains below single-A, the Commission's Competitive Bidding Rule does not apply and is not a factor in its financing activities. However, the broadened Competitive Bidding Rule exemption SCE now seeks reflects its concern that even if and when it returns to a single-A rating status, SCE will continue to face lingering challenges accessing the capital markets. Moreover, given its anticipated financing requirements over the next two years, SCE believes it is important to obtain broadened Competitive Bidding Rule exemption now to avoid possible delay in the future.

5. Relationship Between Requested Exemption and Creditworthiness Status.

As explained above, SCE's creditworthiness status will not prevent it from securing financing, due to its ability to conduct financings on a negotiated basis. SCE states that the further exemption is required because SCE does not expect to be able to competitively bid transactions of any appreciable size even when it returns to single-A status. Given its recent history, SCE contends that investors will require additional assurances that its ratings are stable and that in the face of increased due diligence by investors, additional marketing by SCE

and its underwriters will be necessary. SCE states that the flexibility to pre-market and to test the bond market offered by negotiated transactions will be critical.

6. SCE's Ability to Use the Debt Authority if it Remains Non-Creditworthy for an Extended Period of Time

If SCE remains non-creditworthy for an extended period of time, as stated above, SCE maintains that it should be able to use its debt authority as long as it is not required to use competitive bidding for its financings.

SCE expects that until it becomes investment grade and possibly until it attains at least a high BBB rating, it likely will be limited to issuing secured debt (e.g., first mortgage bonds) as opposed to the senior unsecured notes it issued prior to its credit downgrades.

SCE is currently rated “non-investment grade” by the credit rating agencies. Due to this extended “non-investment grade” rating, even at the low investment grade levels of “BBB” which SCE hopes to achieve in the near future, as well as upon its return to “A” status, SCE contends that it is quite possible that SCE will be unable to access the capital markets using a competitive bidding process.

SCE also explains that there has been considerable consolidation recently in the financial services sector, with the end result of fewer investment and commercial banks. Thus, there are now significantly fewer potential underwriters in the capital markets than there were even five years ago. In a competitively bid offering, the underwriting community is further divided into competitive bidding syndicates, with fewer participants and consequently increased risk for each. Risk is offset by higher costs. As a result, competitive bidding issues in excess of \$200 million are likely to result in a higher cost of funds. Thus, SCE believes that negotiated transactions provide greater flexibility

to adjust the timing and terms of a proposed debt offering to meet changing market conditions.

4. Discussion

In its January 28, 2002 response to the January 10 ALJ ruling, SCE provided the amounts and types of outstanding debt issued pursuant to the various decisions as requested. The amounts of financing authorization remaining under those respective decisions total **\$2,516,040,000**, respectively as follows:

D.88-07-069 ²	\$485,440,000
D.98-02-104	\$193,760,000
D.00-10-063	\$1,586,840,000 (debt) and \$250,000,000 (Preferred Stock)

SCE states that it has a continuing need for Competitive Bidding Rule exemption for issues of large amounts of additional debt. SCE intends to use debt previously authorized to finance any past due obligations, refinance existing debt and fund its construction program. SCE believes its request, effectively seeking an exemption for domestic underwritten public offerings of fixed interest rate bonds and debentures exceeding \$200 million in principal amount, is appropriate given the remaining financing authorization levels of D.88-07-069 and D.00-10-063. Since less than \$200 million in financing authorization remains under D.98-02-104, SCE is withdrawing its request that the relevant language of that decision be modified to permit such exemptions to issue fixed interest rate bonds or debentures exceeding \$200 million in principal amount. In addition, although previously included as part of SCE's petition, in light of D.02-01-061 which granted SCE's request for an exemption from the Competitive Bidding Rule requirements, SCE is not seeking separate or

² While this original decision provided financing authority for a limited duration, it has subsequently been modified several times to extend the financing authority therein (D.89-08-021, D.91-09-076, D.94-07-026, D.95-11-065, D.99-06-018, and D.00-07-012).

additional exemptions from the Competitive Bidding Rule for D.00-10-040 as subsequently modified by D.01-01-021 and D.02-01-061. Accordingly, SCE is seeking additional exemptions from the Competitive Bidding Rule only as to D.88-07-069 and D.00-10-063.

SCE believes that broadening the Decisions' present exemptions from the Competitive Bidding Rule requirements in this manner will give it the greater flexibility it originally sought in its Petition, which it continues to regard as necessary to access the capital markets. We agree. We have examined SCE's October 17, 2002 filing and believe that SCE has complied with the ALJ's ruling. The company provided a detailed update of the record and a primer on the Competitive Bidding process as it particularly affects SCE and other utilities in general.

In D.02-01-061, we agreed with SCE that it was unlikely that SCE would be able to obtain financing through competitive bids in the future. We do not see anything that changes that conclusion at this time. We will grant SCE's request for the exemption from the Competitive Bidding Rules. We note too, that SCE is not requesting authorization for additional debt authority in the Amended Expedition Petition, just an exemption from the Competitive Bidding Rules.

5. Comments on Draft Decision

This is an uncontested matter in which the decision grants the requested relief. Therefore, pursuant to Pub. Util. Code § 311(g)(2), the otherwise applicable 30-day period for public review and comment can be waived. However, this draft decision is being mailed to the Edison general rate case service list for a 14-day comment period. No comments were filed.

6. Assignment of Proceeding

Loretta Lynch is the Assigned Commissioner and Dean Evans is the assigned Administrative Law Judge in these proceedings.

Findings of Fact

1. SCE has previously requested and has received an exemption from the Commission's Competitive Bidding Rule.
2. SCE expects to use current financing authority in 2003 in order to refinance outstanding debt.
3. SCE has \$1.3 billion of PROACT-related debt maturing which will need to be repaid using proceeds from a financing, as described herein.
4. SCE expects that even when it has returned to a single-A credit status, competitive bidding may not be possible for these financings.
5. SCE is not seeking additional debt authorization. It intends to use the debt previously authorized to fund any past due obligations, refinance existing debt and to fund its construction program.
6. SCE has a continuing need for an exemption from the Competitive Bidding Rule.

Conclusion of Law

1. It is reasonable to grant SCE's request for exemption from the Commission's Competitive Bidding Rule.

O R D E R

IT IS ORDERED that:

1. Southern California Edison Company's Amended Expedited Petition for modification of Decision (D.) 88-07-069 and D.00-10-063 is granted.

2. Applications (A.) 00-07-006, A.88-03-024, A.00-07-048, and A.97-11-032 are closed.

This order is effective today.

Dated June 5, 2003, at San Francisco, California.

MICHAEL R. PEEVEY

President

CARL W. WOOD

LORETTA M. LYNCH

GEOFFREY F. BROWN

SUSAN P. KENNEDY

Commissioners