FOR THE WASHINGTON STATE SENATE

ENERGY AND UTILITIES COMMITTEE

WPPSS INQUIRY

Interview of MICAELA BROSTROM and JOHN ATWILL taken before Cheryl L. Lindsey, a Notary Public, at the Institutions Building, State Capitol, Olympia, Washington, commencing at 10:50 a.m. on Wednesday, December 10, 1980.

APPEARANCES:

TERRY HUSSEMAN
DON VOGT
MIKE PEPE
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CURT ESCHELS
SENATOR SUSAN GOULD

OLYMPIA, WASHINGTON; WEDNESDAY, DECEMBER 10, 1980

10:50 A.M.

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MR. VOGT: Let me start out by saying that we very much appreciate the two of you making yourselves available to come here today to share some of the knowledge you have, which I know will be of help to the staff and the senator, too, in terms of enhancing our understanding of financial markets and how WPPSS relates to the larger financial situation in our country.

We can conduct this very informally. Please feel free to respond or ask questions or whatever, both of you or separately in series, however you want to do it, and maybe we ought to start, perhaps, for the record, with a background of your present positions and your backgrounds and experience in the financial area.

MR. ATWILL: I've been in the municipal securities area for fifteen years, primarily on the investment side, with a national bank. I want to emphasize that I am talking for myself only and not for any bank for which I have worked.

I've been in both the underwriting and distribution side of municipal bonds as well as in investing for portfolios, and it is with that background that I'd like to speak to the WPPSS finances and the evolution of that to now and the prospects for the future.

MS BROSTRUM: I've been in the investment business for 21 years, primarily in municipal bonds. For the last two years, two and a half years, I have been with Rainier Bank as head municipal bond underwriter and trader, and I have had experience, also, in financial consulting working with both individual investors and institutional investors.

The bulk of my experience is in municipal bonds.

MR. VOGT: We ought to start with some suggestions you have in terms of the mechanics, let's say, of WPPSS bond underwriting, how that would work, or the mechanics of any bond underwriting for that matter.

MS BROSTRUM: I thought it might be a good idea to put the market we're dealing with into perspective to start with. Basically, debt issuers are municipalities that issue bonds, and there are some 40,000 eligible bond issuers in the United States. Of that 40,000, many of them can issue more than one type of debt. Of course, not all 40,000 would have debt outstanding at any given time. That's kind of the number of different issuers we're looking at.

The issuer would decide to issue a bond. The bond is sold to a group of underwriters. The underwriters then market the bond to the investor.

The investor can be a private bidder or it could be a corporation, bank, insurance company. There are different kinds of investors.

Very often an issuer will retain a financial consultant to assist in the marketing of his bond issue. The consultant works for the issuer. That is, his responsibility is to help structure the issue, help with market timing, but it is all to be to the best advantage of the issuer.

The underwriters are dealers, dealer banks, brokerage firms, who act in the dual capacity as underwriter to the issuer in buying the bonds from the issuer and also in turning around and selling bonds to the investor, so the underwriter and dealers do have a responsibility to the investor.

Under the municipal securities rules-making board there are requirements that the dealers who are selling bonds make sure they are appropriate investments for the investors they're selling them to. We have some rather stringent requirements on us to know both the issuer selling the bonds and to know the person we're selling the bonds to.

During the initial issuance of any bond issue, there is a period of time that it is in the hands of the underwriters while it is being distributed to the investors, that is, the primary market. The only time a bond issue is in the primary market is in that short period of time. Once the bond initially is distributed and is in the hands of the investors, then the bonds are in the hands of the secondary market.

MR. VOGT: I have a question on that, if I may.

If you buy, as an underwriter, some of the bonds for your own account, are those considered in the secondary market even though they don't actually change hands? Am I asking that question correctly?

MR. ATWILL: The underwriter wears two hats in that instance. The underwriter would be acting as a dealer such as Merrill Lynch, an organization such as that, or a bank. Banks have a dual function; they underwrite and distribute securities and invest with their own accounts, and the municipal securities rule-making board is fairly specific on that: If you're acting as an underwriter and you decide you want to make an investment in those securities for your own institution, that has to be fully disclosed to the syndicate, and really, anybody else who has an interest in that, so they have worked to separate those two positions within the bank, so it's almost as if Rainier Bank is trading, or the underwriters are selling, to Rainier Bank as a separate entity.

MR. ESCHELS: Will you be talking about the effect of the secondary market on the primary market?

MS BROSTROM: Yes.

MR. VOGT: Would it be fair to say that the secondary market exists as soon as the bonds are sold, that the secondary market starts right away at that point?

MS BROSTROM: Generally any syndicate has syndicate restrictions as to price, and those restrictions are in effect and are binding on every member of the syndicate as long as the manager determines -- generally it's up to the manager if someone is not a member of the syndicate -- to be bound by the syndicate restrictions.

MR. VOGT: Bound by a price below which they can't sell or what?

MS BROSTROM: Right. Let's say the offering is par at 100 and there is a one-point concession to the dealers, that is, the wholesale market. They cannot sell at a price lower than that, and they can only sell at that price to other dealers. If they are going to an individual or investor who is not a registered dealer, the price is par. Now, they can be sold above that price, but not below that price.

MR. NEALE: Is that absolute? Could they decide to sell below that price and take the loss themselves?

MS BROSTROM: No, they can't do that unless they have either the manager's or syndicate permission to do it. That can only be done with permission of the syndicate or manager.

MR. NEALE: Does the issuer have any say in that?

MS BROSTROM: The only time the issuer would have a say would be if it were negotiated, but there is a difference between a negotiated deal and a competitive deal. There are all kinds of subtleties. If it is negotiated, any price change would have to be approved by the issuer, but you still have the uniformity of offering price, in that at any given time, the same offering price is made to everyone. You don't have one price for one investor and one price for another investor. The only exception is that you do have a dealer price and a net offering price to allow the dealers to make some profit, but there is a uniform offering price at any given time in the primary market.

MR. VOGT: How do members of the underwriting group avoid selling to the same people, or do they compete with the same secondary market? Let's see if I can think of an example. Say a wealthy individual might get a call from both Rainier and some other bank, and they're told, "Say, I have some bonds to sell you," or something. How is the price set? It can't fall below this price that has been set, right?

MS BROSTROM: Correct.

MR. VOGT: Is it more just customary that people rely on one institution to service their investment needs or how does that work? Can you generalize?

MS BROSTROM: Pretty much so.

If you have an instance where an individual is dealing with more than one broker or more than one bank, he may make his decisions--and here now, we're assuming that the price is the same-- but say two different dealers are offering the same individual the same security at the same price. He could decide arbitrarily which one he wanted to do business with, or he could buy, say, 10,000 from one dealer and 10,000 from the other, or he could just make the decision to buy from the first person that came to him.

MR. ATWILL: That's really the perfect system. In actuality what happens -- we're really talking about major institutions -- you're relying on the advice of one dealer versus another. It could be the advice of a dealer saying, "Look, I'd say in a week"-- or day or hour --"that rates will change dramatically. My advice is don't buy now; wait until they break the syndicate restrictions." So that's operating, and while technically they're not selling them at a lower price, they are cautioning the investor not to buy now, or conversely, to buy now, because they could go up in price. That's hard to stop but that's often what an institution bases its decisions on. That's kind of information on the marketplace itself, not on specific issues. The price, as Micaela says, is fixed. It's not going to change as long as it's within the syndicate.

MR. VOGT: If you're an underwriter, though, you won't necessarily want to give that kind of advice, would you, or you'd end up being stuck with the bonds. I don't mean your company but --

MR. ATWILL: From a pure profit standpoint, no, but from the fact that you want to stay in business.

MR. VOGT: I see.

MR. ATWILL: You don't want to soak somebody, either. When you see something coming like that, it may be better to take that loss then never do business with them again.

MS BROSTROM: Along those same lines, and referring to the WPPSS issue which sold yesterday, there were something like 190 million of the twelve-and-a-half bonds going to a thousand dealers of those bonds, all going out of the syndicate, which would make it appear that those bonds were very popular and people could make the assumption that they were all placed, but that wasn't true. They were mostly in the hands of the underwriters who took them to then resell to their accounts. While the syndicate didn't have any of those bonds left, they were available through the individual members of the syndicate and were being offered this morning.

SENATOR GOULD: Did WPPSS accept that? Did it accept the long-term --

MS BROSTROM: Both. Both issues were sold.

MR. ATWILL: This is often a point of confusion. You're talking about the syndicate. That can be Rainier Bank. Rainier Bank also has an advising position and a group of customers. We can sell from the syndicate direct to the customers or, as in this case, the syndicate confirmed all the long-term bonds to the syndicate members. At that point, they are no longer owned by the syndicate, they are owned by the individual members, and price restrictions may or may not still be in place, but they're owned by the syndicate members individually, and they're out of the syndicate, so in terms of profit or loss of the syndicate, there is no market risk. In terms of the fact they have not been distributed, individual members stand at risk in the marketplace.

MR. HUSSEMAN: If the syndicate comes in and bids on a WPPSS package, they have prior commitments from the members of the syndicate to take a certain amount of the total package, so that as soon as their bid is accepted, they know how those 150 million or whatever it is in bonds is going to be distributed amongst the members of the syndicate, and each member is on their own to sell those to their own investors.

MR. ATWILL: That's a more efficient distribution system. Each member of the syndicate has specified liability. You take that percentage and you're alotted or confirmed those bonds, and that's so that immediately the secondary market can start operating on those bonds. If there's a case where Rainier can sell some of the longest bonds rather than the short ones, and somebody else has the reverse situation and wants to be able to sell the short-term bonds, you want to be able to sell those back and forth between dealers.

MR. HUSSEMAN: So then the syndicate actually is selling them to their individual members. The syndicate makes the bid and then the deal is arranged so that most individual members are going to buy so many of the bonds. Does that mean the bonds are now by definition on the secondary market?

MR. ATWILL: When that happens. Don't have the impression that always happens on WPPSS deals. It traditionally happens on the term bonds, but on the serial bonds, those remain in the syndicate.

MR. HUSSEMAN: Is there anything unusual about doing it that way?

MR. ATWILL: No. For a more efficient distribution system is the reason it's done that way.

MR. HUSSEMAN: And the members of the syndicate are committed on price as to what they're going to sell to their investors for?

MR. ATWILL: They have the option of staying with the syndicate or being released. Once they agree to the price -- this happens before the bid is submitted; the bid is submitted and when it's accepted -- then the syndicate manager normally will turn around and confirm those bonds immediately on WPPSS term issues, and that happens on a lot of municipal bond issues where there is a large quantity of term bonds. That wouldn't happen in the case of the State of Washington, for instance, who sells serial bonds. Those remain in the syndicate. They have an order period and the syndicate members go out and solicit orders and submit them. The syndicate manager allocates the bonds. There probably will be a balance left at the end of the order period. The balance is still owned by the syndicate as a unit. Then after a few days, or even sometimes a couple of weeks, if those bonds have not been distributed at that point, the syndicate decides it's time to distribute those to the members and let them individually seek a market level for those bonds.

MR. NEALE: From the syndicate's standpoint, isn't it best to place those bonds, whether serial or term, as quickly as possible.

MR. ATWILL: Certainly.

MR. NEALE: Is the amount of time that elapsed since yesterday's sale and this morning's fact that not anything is placed: Is that significant or not?

MR. ATWILL: That's a problem of judgment that the syndicate priced that issue yesterday thinking it could be all sold. Anytime you have a situation like WPPSS has where they come to the market essentially, "We'll sell bonds due these dates at these amounts," maybe the demand isn't there, so they're going to sell on December 10. Maybe you don't have all your orders lined up so you make a judgment that you can go out and create a demand for those bonds. It can be good; it can be bad, and the WPPSS situation, with the kind of supply they're coming in with, it normally would be bad to have that kind of thing happening. The market is chaotic now. Really, that's not a good example of this.

MR. VOGT: Serial bonds as opposed to term: Term bonds are the ones with the fixed maturity and serial bonds --

MS BROSTROM: All have fixed maturity. Term is like planned maturity. In this case, you have 100 million iwth the same interest rate, all with the same maturity. The serial bonds were the bonds that ran from 1989 to 1993 where there was like a million or two million. You're also thinking of the PUD bond or the Series E fifty million, which are also term bonds but that was a separate type of issue where the investor, the person that buys them, has the option of tendering those bonds at par beginning in 1990 even though they have assorted maturity dates.

MR. NEALE: Sort of like the bond option market.

MR. VOGT: If I understand -- just one more stab at this -- if the syndicate is holding these serial bonds out hoping to sell them, what is the risk to the members of the syndicate? Say you hold onto them and sell out fifty percent in a week or two, or maybe two days. Say you can't get rid of the rest so you dump them, presumably to get rid of the. How do you allocate the loss of that type of process.

MR. ATWILL: Take a simple case where you have a million dollar deal. You have five members. Each one has $200,000 worth of liability if the total issue is sold. If 50 percent is sold, it's fifty percent of the remaining liability.

MR. VOGT: Shared equally in other words?

MR. ATWILL: All based on what your original liability is. In the case of WPPSS underwriting, the senior underwriters have a liability of 25 million a piece. The regional firm might have a liability of a million.

MR. VOGT: So you indicate what, presumably if it's a hot one, you don't get as many to sell?

MR. ATWILL: It works both ways.

MR. NEALE: You set it up contractually?

MR. ATWILL: Right.

MR. VOGT: It's a totally independent transaction.

MR. ATWILL: That's the syndicate.

MS BROSTROM: When you set up the syndicate, any member invested in it commits for a certain amount or percentage of that issue. Then he has the option of, at the time the issue is actually priced, whether to maintain that commitment, drop out completely, reduce participation, or, in some cases, increase participation.

MR. VOGT: All depending on if it's oversubscribed or undersubscribed?

MS BROSTROM: If it's a good deal or a bad deal. In the instance of WPPSS and the sale yesterday: With the frustrations and the vulnerability, things we're seeing going on in all market areas, there is increasing risk. As we saw happen this morning with the prime going from 19 and a half to 20 percent, that obviously won't help in the marketing of WPPSS.

MR. NEALE: I heard that Chemical Bank decided not to participate in this as part of the syndicate. I was also told that was significant, but I don't know why. I wanted to ask somebody.

MR. ATWILL: It could be. I don't want to speculate. Let me give you a couple reasons that might be behind their decision.

They may see that there is a risk in selling that issue to a customer in terms of future liability if some WPPSS go into default -- not just WPPSS, anybody.

A second reason is as a bank, they may have made a decision not to buy that category of bond for their own portfolio and they don't want to be in a syndicate trying to sell that to other banks. If that became obvious they may just say, "The market is so chaotic, we think the risks far outweigh the opportunity to have a profitable transaction." In fact, that did happen on four and five. No banks are involved in four and five. I don't know where your information came from, but part of the Banking Law 33 prohibits banks from underwriting certain revenue bonds. They can underwrite one, two and three because they're backed by Bonneville. Four and five are generated by participants and Chemical could not participate in underwriting. Maybe what you heard is that they decided not to buy any for their own investment account.

MR. NEALE: I was trying to partly confirm that and find out the significance.

MR. ATWILL: That kind of information filters through the market from time to time on many issues. "That bank or this bank has ceased buying" whatever it is. It's as cryptic as that, and trying to assess what reasons they see for doing that --. They have access to the same information we do. We say, "What are they seeing that we don't see?"

MR. NEALE: There was a whole series in the <u>Wall Street Journal</u> talking about pension funds in the state of California having decided to buy no municipal issues of any sort. That's the kind of rumor you're talking about, plus the ones not published.

MR. ATWILL: Well, there are different definitions of risk, certainly. If somebody says nuclear is a risk they don't wish to assume because there is so much unknown, it could be just a policy decision that they won't invest in nuclear.

MS BROSTROM: A number of the dealers did not participate in the most recent WPPSS sale. They do have the option, based on price, not to participate if they don't feel they can sell. What they sell is their liability. They elect to drop out rather than lose money.

One of the significant firms that was a dropout on this issue was First Boston which has been the manager of the third bidding group, and they simply felt they could not market to their customers at these levels, did not see any interest at these levels among the accounts they covered where they expect to make money rather than lose money.

SENATOR GOULD: What levels?

MS BROSTROM: The interest rate level.

MR. VOGT: They've been courting WPPSS, too. They had a nice study they did for WPPSS showing what they were doing to try to make a market for WPPSS bonds and so on. That's something. So the gossip mill or whatever in the bond trading business is such that you know who is in the original syndicate, who pulls out, when they go to the confirmation of what their share is?

MR. ATWILL: That would normally not be an issue because people who want to buy bonds need to know who is in the syndicate, so that information is normally known. You know who the lead underwriter is. Those still in the account would call and say, "I'm in the account if you want to buy any bonds from us."

MR. NEALE: Are there different strategies to say, as an underwriter, whether or not to get into the serial or term bonds?

MR. ATWILL: You're in all -- the whole bond issue. You can't as an underwriter say, "I just want a participation in term bonds."

MR. NEALE: In terms of selling, then, is there a different strategy, different profitability between serial bonds and term bonds.

MR. ATWILL: From time to time the market for different categories changes, so they will put incentives into certain maturities or categories of bonds to make those more attractive to sell. The serial bonds yesterday had a dealer discount of a point, but the syndicate members got a point and a half more to sell the serials, and the term bonds had an additional two and two and a half points.

MR. NEALE: Isn't that larger than the normal underwriting fee?

MR. ATWILL: Yes, but this is a market where the risk was enormous and it could very well be that that three or four point cushion is not going to be enough to prevent them from taking a loss. It's an assessment of what your risk is. Right now the assessment is very high.

Another good example is the State of Washington issue that did not sell a few weeks ago. A year ago that issue would have been underwritten for a point or a point and an eighth gross profit. I think they had almost three points' profit in that period.

MS BROSTROM: We are now seeing two to three times the amount of profit built in as a cushion against loss. That expands and contracts.

There may be two components of that. One is the general market condition; and secondly, the peculiar qualities of a given issue.

MR. VOGT: Is there any way to sort that out so that over time you can begin to see what is what?

MS BOSTROM: Over time you can begin to see that with certain issuers, there is a market perception that they are an undesirable issuer, as opposed to its being a bad market situation.

MR. ATWILL: You have to be careful of the term "undesirable." New York City was undesirable as an issuer when they were getting in more and more trouble and the underwriting spread increased. That's only one component. The other is simply the market we're involved in now, and WPPSS has accelerated its borrowing, to be specific, as interest rates have gotten more and more volatile over the last four years, so is it that that has required the underwriters to increase their spread, or is it the difficulty many claim that they can't find buyers? As an aside, we hear the comment almost every time they come to market, but they all have gotten distributed up to this point, so somebody's buying them. The reluctance is perhaps in certain categories, but other people are saying, "Gee, there seems to be real value there."

It's not as if these bonds are unsalable; it's just taking a higher and higher rate to sell them, as it is to sell any fixed-income instrument these days.

MR. NEALE: How big is the municipal market annually?

MR. ATWILL: Close to 50 billion.

MS BROSTROM: Last year it was near 43 billion; this year we expect 45 billion total. That includes short- and long-term in the primary market. In the secondary market it's close to 300 billion.

MR. HUSSEMAN: What is the breakdown on the short- and long-term?

MR. ATWILL: That doesn't include notes. The 43 billion is all bond financing including serial as well as term bond issues. Note financing like project notes or short-term notes like the State was contemplating would probably add another 45 billion, depending on the market environment. That isn't really accurate, but it can't be accurate. That's close.

MR. VOGT: If WPPSS is going on one billion dollars a year -- that means that it's two or three percent of the municipal market all by itself -- is that a significant force?

MS BROSTROM: I'd say yes.

MR. ATWILL: In a historical sense, yes. I think today you're seeing a very small group of issuers accounting for an ever-increasing percentage of the total bonds sold.

The State of Oregon comes to mind. They have accelerated their amount of bond issuing for veterans' mortgage program. Certainly the category of public power bonds has accelerated because that's what needs to be built now.

MR. NEALE: One statistic WPPSS gave us was that since 1976 WPPSS bonds have accounted for 55 percent of the Joint Action Agency Revenue Bond, and to me, that sounded significant. I was trying to determine their effect on the whole municipal bond market.

MR. ATWILL: I saw a short version of that quote in the paper about two weeks ago and I didn't understand it because they left out the "Joint Action" and just printed "Revenue Bond" which I knew was false. Then I saw the reference today. I really don't think that's significant. As a percentage of all revenue bonds, that percentage amount would be significant; as a percentage of all public power bonds issued, that would be significant; but I'm not sure it would really have a detrimental effect on the marketability of WPPSS bonds.

MR. NEALE: I was trying to determine whether or not there is an either positive or negative effect.

How significant is the fact that they're at 12.4 or so? Does that lead the market in that direction?

MR. ATWILL: Let's put it this way: If every other public power issuer stopped issuing bonds and WPPSS continued to increase, their rates would go down because they would be the only ones issuing. It's the fact that they're in concert with the federal government trying to fund a deficit, in concert with ever-increasing needs for all municipal services coming into the same market. Add to that market the attempt to finance single-family housing, hospitals, things that have never been in that market before, and you have all these people trying to get through the same door.

I think Jim Percoe's testimony, Bill Appel's testimony -- some reference was made to the fact that the buyers of these bonds are diminishing their demands and those are primarily economic reasons. It's not the fact that they don't want WPPSS bonds or housing bonds. Maybe they don't need tax-exempt income; they're at that point in the cycle. This is a cyclical market.

A case in point: Casualty companies are being mentioned more and more. They are a huge buyer of tax-exempt securities. The industry is surprised every year when they come up with the total amount of bonds they have bought, because if you look at the historical cycle, the casualty companies should be at a point where rate increases are now being absorbed by rising claims because of inflation, and the need for tax-exempt income would be diminishing. I know of cases on the West Coast at least where there have been moratoriums on any new municipal bonds being bought on the part of these companies. I would expect that to continue on into the 1980s.

MR. NEALE: How long is the cycle?

MR. ATWILL: Usually it is a five-year cycle.

MR. NEALE: We're at a low point now?

MR. ATWILL: We're going into it in 1981. At that point, we will substitute another category of buyer. Historically the commercial banks come in. The loan demand is down and they need to put their deposits to work somehow. That won't help this time. I don't think the individual market at this point -- people are saving more and looking to invest. This time around it will be probably in the form of purchasing bond funds or some of the short-term money market funds.

MR. VOGT: Intermediating?

MR. ATWILL: Everyone is intermediating, not just the banks.

MR. NEALE: A question arises out of that article in the <u>Wall Street Journal</u> on the effect on the secondary market. Because of high and steadily increasing interest rates, the WPPSS bond prices are way down. The August issue this morning was put at a bid of 71 and a half. Doesn't that tend to invite people to sell those things and take the tax loss and put their money someplace else? Would that be a signal that will also drive up the price of the issue yesterday?

MS BROSTROM: It drives up all bond prices. Bonds are a money market instrument competing with every other type of investment, long-term, medium-term, short-term. As John was explaining, rates have been going up, so even in the secondary market the old bonds outstanding have to compete with the new issues coming at higher rates. They have to adjust their price. There are lots of people selling old WPPSS, old bonds of any kind, taking the tax loss if they have the tolerance, and going into some other investment. That's not just the WPPSS market; that's the market in general.

MR. VOGT: I'm wondering if we might let Ms Brostrom move on to let her cover the other points and then we'll come back to questions afterwards.

You were talking about the syndicate.

MS BROSTROM: The primary market and the secondary market were next on my list, the differentiations between the two.

I think we have probably covered that.

Now, the relationship of the primary market to the secondary market, as far as pricing is concerned, the point I just made is that bonds in the secondary market compete with primary market bonds as well as all other types of investments. There is definitely a relationship. Any time a new issue is priced in the primary market, consideration is given to what is available in the secondary market.

We also just touched on the perception of a bond investor as to the market value of A credit. There used to be a direct correlation between the rating of the bond, A, B, AAA, AA, and the market value. That is not necessarily true anymore, and probably WPPSS is the primary example. We have AAA WPPSS, which is the highest rating assigned to any bond, but its marketability is not the same as other AAA bonds, so a number of factors now are causing divergence between credit rating, ability to pay, credit worthiness of any issue and its market price, its market value as perceived by the investors.

MR. NEALE: That's what the First Boston presentation said, too. When was the changeover where they were selling above other issues?

MR. VOGT: I wish I had brought that chart. It showed a First Boston rating of municipals over time and the WPPSS net billed at 45 and for a while all municipals were under that composite rating. Two or three years ago they switched and started selling higher than the composite.

MR. NEALE: It was, I think, some special index First Boston created. I don't know if it was just par issues or municipals generally or some index they had. One question that arises out of that: What factors would cause that to occur? Just the volume of WPPSS?

MS BROSTROM: Part of it is volume. Part is what is referred to as saturation point, the fact that so many portfolios, professional and individual, are saturated with WPPSS bonds and want diversity, don't want all their eggs in one basket, even AAA WPPSS. They may feel they have enough WPPSS regardless of the price and they want something else.

Then you're in the position of having to attract other buyers who may not traditionally have needed tax-exempt income, so the rate has to go up and supply definitely can be a handicap.

MR. HUSSEMAN: Can I ask a question on saturation point? That's what Blyth Eastman is telling WPPSS, that their investors are saturated with WPPSS bonds. How much distinction is there between portfolios being saturated with 1, 2 and 3 net billed bonds and 4/5. If you have a lot of WPPSS bonds that are from the net billed, perhaps, is that going to stop you from buying any WPPSS bonds or are you always going to be willing to buy the net billed because they are backed by the Bonneville Power Administration and maybe you get out of 4/5s. Is there some distinction in the saturation point between the two categories of bonds?

MS BROSTROM: That probably depends on the individual portfolio.

John, you could answer that more specifically.

MR. ATWILL: I think there has been some evidence that as the possibility for Bonneville's backing 4 and 5 has ebbed and flowed, the desirability of those bond issues has kind of matched that, but I think as a category, at least the banks I'm talking to, some of the casualty companies, they look at WPPSS as a total and don't distinguish between 1, 2, 3, 4 and 5. They see the same participants, same management, the fact that they're all under construction. There are similarities that don't have to do with securities. In fact, I can remember three, four years ago the suggestion was made by several of the casualty companies to WPPSS that, "You really ought to call 4/5 something else because we could buy more if you named them 'Power Supply of Washington' and put them in the "P" section instead of the "W" section."

MR. HUSSEMAN: Sophisticated investors.

MR. NEALE: First Boston said the same thing that there was no distinction in their customers' minds.

MR. ATWILL: I think any time you have a situation where you, let's say, can attribute to the nuclear industry that you have people reluctant to buy a particular category of security, they're going to look at it and see all WPPSS bonds and say, "I don't want to buy anymore." They're saying that there are problems with the nuclear industry or whatever or as Micki suggested, "We're saturated with nuclear holdings and we don't want to buy anymore."

MR. HUSSEMAN: Let me follow up on that. The reason I asked is because WPPSS, in going to balanced financing says -- or the recommendation to go to that says -- that because of the saturation, we have to sell a certain amount of short-term, but if, in fact, all 1s, 2s, and 3s as well as 4/5 bonds are saturating these portfolios, then if they can only sell, say, 200 million a year of short-term, and 4/5s are still putting more than a billion dollars a year of new bonds into these saturated portfolios, could you comment on how unsaturated these portfolios can get when there is still a billion dollars a year going out, theoretically, into the market of long-term bonds?

MR. ATWILL: That's been mulled over for a long time and I'm not sure I have the answer. I have a couple thoughts.

I think the idea of saturation is perhaps misleading. I think what you really have is a situation where those portfolios that have traditionally invested in fixed-income securities are altering their view of the future in terms of the locking in of income. They're saying, "We believe we're going to have a volatility of interest rates over the next decade. We really want to insulate ourselves from that volatility by matching our source of funds, which is deposits, to how we employ them." It doesn't make sense to take on a six-month CD and buy a 20-year municipal. If you take that a step further, they see very little reason to own municipal securities. In a lot of states they have reduced the requirements for loaning against public deposits for mechanical reasons, for reducing the total number of portfolios. Those things are operating and having an effect on both the issuer and the underwriters. They believe that those portfolios are saturated when, in fact, they may not be buying any bonds -- not just WPPSS, but no category of bonds.

At the same time, I don't think that the balanced financing approach that Blyth has presented really solves the problem, if what I'm suggesting is the case. What I'm suggesting is there is going to be difficulty selling that debt. Whenever you go to the long-term market, you're putting off the day when you have to face the reality that the cost of selling that issue is going to be lots higher than you're comfortable with, and my own feeling is that the market is a great indicator of the future. Right now this market is telling us we'll have lots of volatility; we'll probably have periods of even higher interest rates than any of us has ever seen, and that the chance of the rates coming down to single-digit is unlikely. There are going to be occasions when that will happen, but that won't be the norm. If that is the case, and you don't have to look back to the decade of the seventies to see that if as WPPSS did, it took every opportunity to sell in the long-term market, those were wise decisions.

I think the same thing applies today. There are vehicles that can be constructed to buy long-term bonds and sell short-term participation. The easiest people to sell WPPSS to have bought all they're going to. Now we have to go out and find another market. I don't think that the balanced financing is really going to tap that market in a cost-saving way. Ultimately you have to develop that market through permanent financing, do it through federal funding, make it a taxable deal through Bonneville, do it through higher yield, pass it on to the participants. You can do it through coercion I suppose. You can tell people, "Look, if you want this power, you have to take an equity participation in these projects," so the easy answers we've exhausted. I think the balanced financing plan is an attempt to put off the day of reckoning to that reality because you have 10 billion dollars, at least, of additional financing to do. How many times do you want to do it? Roll it over yearly and get it done in ten years? Do it as you need the money and kind of pay the piper? My feeling is the market would accept the latter far more easily than they would accept this idea because to go through with the long term permanent financing today , WPPSS will have to do an awful lot more analytical studies of the ability of the PUD participants to pay for this power given a worse scenario, something they haven't even begun to do.

We were talking about this on the way down today. To back up a minute, two years ago WPPSS came with an issue. Let's say we had to pay seven and three quarters for that issue. A week later Clark County came with that issue and paid one point less and you couldn't find one investor in a hundred who would believe the obligation of Clark County was a seniorling to that bond. That's market ignorance that is to some extent still true. I think a lot more people have discovered that. The point is, what is the ability of those PUDs to pay for this power; how high will they raise rates and still have people demanding the same amount of power? Those questions aren't easy to answer. You can do an analysis of population growth, load demand, some of the conservation techniques that come into it and arrive at a rate that will have to be paid by the consumer to justify spending, say, 25 billion, and the WPPSS plan takes a much higher number than they're looking at. WPPSS is always surprised; they say, "Gee, let's escalate another billion and seven; gee, let's escalate another billion," and they never look at the cumulative effect, impact, on the people who are ultimately going to be paying for that power. I heard it suggested the other day that any PUD that could generate hydroelectric power at 100 mills or less ought to think about doing that. That shocked me, because I knew 4 and 5 was going up; I thought it was closer to 70 mills when completed. I think the rate payers ought to know that.

I mentioned earlier the elasticity of demand will come into play. All you have to do is talk to the person next to you and ask, "What are you doing to save energy?" Believe me, if you double the cost of power, they'll do a lot. When that assessment is made, I guaranty and reveal to the investing public those bonds will sell because everything you need to know will be known right up to the last WPPSS deal. Those have been sold on faith; Bonneville's behind them; don't worry about it.

SENATOR GOULD: What you're saying -- I'm reiterating, but I want to be sure I'm right -- is that if investors knew that coal-fired or hydroelectric generators would be as expensive or more expensive than what the ultimate cost we believe -- if there is any belief -- what the ultimate cost will be of WPPSS power, if they knew they would be higher, they would then be willing to take an even broader look at WPPSS bonds, would feel more comfortable about them?

MR. ATWILL: Not exactly. I guess what I'm suggesting is an investor in WPPSS bonds can be paid back by a consumer within a PUD district. That consumer doesn't have the slightest idea what his rates will do. Even from the WPSS perspective, there has been no attempt made to look at the ability of the rate payer or the willingness of the rate payer to consume power at those rates. What I'm talking about -- take the worst case. Say the plants, when done, are worth 25 billion dollars. Flow that back down to the participants and see what that rate payer will have to pay in Pacific County, Clark County, Grant County, Snohomish County, Tacoma. Then you'll have a realistic idea of how cheap that power is, how competitive for other areas, how marketable it is -- if they don't want it -- somewhere else. That's really the basis of 4 and 5, all the WPPSS projects: Is that power, when it finally comes on line, going to be used, and if it isn't, is it going to be sold? We don't have an idea of what that power will cost or the willingness to use it.

SENATOR GOULD: When you say "somewhere else," do you mean outside of this grid?

MR. ATWILL: Yes.

SENATOR GOULD: WPPSS doesn't have an idea what that market will be, or if they do, they haven't been willing to publish it.

MR. ATWILL: They allude to it, though, every time I talk to them. That's by comparison. The Southwest is paying maybe 10, 20 percent more for power, but I don't think anybody has looked at that question for the last six or 12 months. With our deepening escalation of costs, they don't know how to. But I'm getting back to the point of the ability to market the power in this region. I'm not being pessimistic. I think if you did this analysis, the result would be that yes, that power will be used; it would be an economic way to go, rather than alternative coal-fired generators started now or some other project. We simply have to get away from the idea that anybody is going to get cheap power, and let's define how expensive it will be. We'll find out it won't be as expensive as the people in Georgia, Massachusetts or New York have it and probably not as expensive as the people in the Southwest are paying.

SENATOR GOULD: Or will be paying.

MR. ATWILL: We need to feel those costs are within reason and that there will be a consumer out there to pay for the power. That's the only way to assess if you're willing to buy bonds.

MS BROSTROM: WPPSS has not studied what the power will cost. Since they don't know when the projects will be completed or when they'll be operating, it has never been extrapolated to the ultimate end, and that's what they need the independent study to define: What will be th ultimate cost to the rate payer; Will they be able to pay it?

MR. NEALE: That they can market that power elsewhere is the fall-back position, and we've heard rumors that a lot of other groups are thinking the same thing: If we can't sell it here, we'll sell it in California.

MS BROSTROM: How do you know you'll be able to sell if you don't know what the price will be?

MR. NEALE: Price is one thing, but just the supply -- Utah is planning on selling to California; WPPSS is planning on selling to California; Arizona is planning on selling to California. Unless all of those people are talking, they may be counting up the same number of megowatts, and they may find out if that time comes that there isn't a market.

MR. HUSSEMAN: Let me crank another idea into that and ask your comment. It seems to me the decision-makers, on pushing for the completion of 4/5 -- whoever those decision-makers are -- it seems to me we need to know whether they're pushing for the completion of 4/5 to provide power for California or because we need it here. It seems to me it makes a difference in how much you're willing to accept in the way of costs; in other words, what I'm saying is if your study shows that the elasticity of demand would mean that at those prices, consumers in this area would use less, therefore 1, 2, and 3 would be enough to furnish power needs of this area, so we have to find outside buyers for the output of 4 and 5, then in effect, we're pushing for 4/5 to provide power in California.

MR. ATWILL: I think that's a good question.

SENATOR GOULD: The answer to which nobody knows at this point.

MR. ATWILL: That's a good place to start talking about a moratorium on 4/5, to slow down, get a plant operating and find out what the costs are.

SENATOR GOULD: That was what I wanted to ask: Maybe we should know what will be the effect on the market of current bonds if WPPSS decides to put a moratorium on 4/5?

MR. ATWILL: Favorable in my opinion, because as you diminish the supply of new debt for WPPSS, that will come out as a positive; secondly, the old, outstanding 4 and 5s are secured by the ability of participants to increase rates and pay off the debt service, so I think that's fairly well assimilated into the market. I haven't made a calculation of what the rate increases will be. Those bonds, I don't think, will suffer. I am not certain you'd want a moratorium on 4 and 5 only. My feeling is that it would make more sense to moratorium 3 and 5 -- those are the Mirror plants in Satsop -- get the ones operating on the Satsop reservation. Then you've put a moratorium on one of each class of WPPSS issued. The market would be indifferent to that. In my opinion, it would be a positive. It would be an indication that WPPSS was trying to get its arms around a huge problem they have, and that they now have two less problems to worry about. Down the road you can then tell the market that you are putting on the moratorium, but in three years you expect to start construction, no surpirse or speculation about when you're starting up again, because that speculation is just as bad as if they continued to finance 4 and 5.

SENATOR GOULD: The next question I have is perhaps one you would not be able to answer, but it does bring to the front a problem -- one which we've sort of been hoping under the Northwest Regional Power Bill that the Bonneville Power Administration or Council may take on -- and that is the backing of the Bonneville Power Administration of 4 and 5, if shot down on an interim basis, what effect that would have on the decision. That is speculation. I don't know who's on the Council yet.

MS BROSTROM: You'd have to do the study anyway.

My understanding is that it would take at least three years.

SENATOR GOULD: That's optimistic.

MS BROSTROM: Conceivably by the time the study was done, the plant would be completed anyway.

SENATOR GOULD: I was saying if the moratorium were on.

MS BROSTROM: If the moratorium were on and, say, it was a three-year moratorium, three years after the study was done, that timing would be appropriate for Bonneville to take over at that time. That's the way I'd look at it.

SENATOR GOULD: I like that.

MR. ATWILL: I think you could make a good case for Bonneville to take over.

MR. HUSSEMAN: For shutting down 4/5 as opposed to 3/5?

MR. VOGT: There's something interesting in Mr. Patterson's testimony that I'm looking for here.

MS BROSTROM: Who is he?

MR. VOGT: A financial advisor that WPPSS had that we interviewed. I don't find it here immediately. If I'm being fair to him, his perception was that it would be a mistake to consider shutting down 4 and 5, for example, because the investment community would say, "Well, didn't WPPSS know what it was doing? Gee, if they started a big project like this and now they're shutting down --." In other words, they would wonder about bad judgment, and wouldn't that undercut the confidence of investors in general management and so on. How do you react to that?

MS BROSTROM: That fits in with the comment I wanted to make on the objections we run into in trying to sell WPPSS bonds to investors. This probably applies more to individual investors than institutional, but it applies really to both. One is the increasing feeling that WPPSS is going to be issuing an infinite supply of bonds, that there's not going to be any end to it so there's no reason why they should buy any given issue; the other is, "Why should I buy this issue when in a month and a half there will be another, and with interest rates it will be higher then?" We have no response to that other than, "If you know for sure interest rates will be higher, perhaps you should wait. Even if rates do start to come down, that doesn't mean WPPSS rates on their bonds will come down."

SENATOR GOULD: That may be why WPPSS decided to accept that rate rather than trying to negotiate 150.

MS BROSTROM: If they waited with the prime going up --

SENATOR GOULD: They might have decided it was going to get worse.

MR. NEALE: They said they didn't have the money to go very long.

SENATOR GOULD: I thought they had 60 days.

MR. VOGT: Until April 5 to 8, that would be another eight weeks.

MR. NEALE: We're getting conflicting numbers. I think they said six to eight weeks without the sale. The management information report at the end of October said they had a two-month supply.

MS BROSTROM: Among the dealers I talked to and investors alike there is increasingly a feeling that if WPPSS could show they knew what they were doing by getting one plant operating as quickly as possible, it would restore investor confidence. That's why I feel the moratorium would be perceived as a positive step by the dealer community. It would show WPPSS was at long last getting a handle on things rather than continuing to create an Octopus nobody knows what is going to happen to.

SENATOR GOULD: I think Ferguson was working on that basis. He wanted to get two done to prove it could be done.

MR. NEALE: If they do turn on two in 1982 sometime and in the meantime they continued working on the other plants as scheduled. The schedule has continued to slide and NRC won't give an operating license or they send a long list of deficiencies or questions they have about it. That's one problem all by itself. Does that factor on the financial end of it hurt other WPPSS plants?

MS BROSTROM: I think the street would tend to extrapolate that times four more plants. Here you would have 16 or 17 billion dollars invested in construction plants which are not allowed to operate or will require conceivably additional amounts to operate.

MR. NEALE: Even though they're completely separate plants?

MS BROSTROM: I think there would tend to be that association. My feeling would be if the WPPSS management, working probably with the NRC, showed they were working together in an informed manner all along, rather than waiting until the plants were 100 percent constructed and then saying, "Now, about the deficiencies --."

MR. NEALE: Talking about the infinite supply of WPPSS bonds and the idea of saturation, something I expressed before: If WPPSS has gone out in the last five years with between five and seven billion dollars and apparently saturated at least their historical investors, and the plan is to go for another eight billion dollars in the next four or five years -- that being double the rate -- can they ever get back into the long-term market having saturated it already at the rate of about five hundred million dollars a year? My second question is, could they run a danger of running the same saturation problem in the shorter-term issues, being two separate markets.

MR. ATWILL: I don't think they're two separate markets.

MR. NEALE: Time-frames or whatever.

MR. ATWILL: As I suggested earlier, I think the demand for that type of credit is shifting on the part of the investors. I think the investor out there will buy the WPPSS bonds. That's where saturation comes in. You can't sell it to the dumb institutions anymore; you're going to have to pay a higher rate of interest to attract that other pool of funds that is out there, not because they're saturated, but because the casualty companies don't need any more investments, fixed-income securities, period. Even if WPPSS was starting over today, that would probably be the case, so I guess what I'd like to do is get away for a moment back to the question about Don Patterson.

MR. VOGT: I wanted to read that to you.

MR. ATWILL: I read Jim Percoe's testimony and I have had an uneasy feeling for a number of years that WPPSS was not being well served by their financial consultants. I think they were totally honest and well meaning in all they did, but they were not giving a balanced view of what the world was like out there, and on WPPSS part, WPPSS was not checking with any other sources. They heard the word from Blyth and assumed that was the case.

I think that was true about the balanced financing proposal. By the time April of 1980 arrived, that balanced financing proposal was outdated by at least two years in terms of what it would accomplish in the market it was addressing itself to. I think that was a problem with WPPSS in other areas, too.

MR. VOGT: A day late and a dollar short.

MR. ATWILL: They sought the advice of only one oracle and the consequence was that they suddenly cannot understand why their bonds won't sell so they take an easy theory that the market is saturated when the case is that there are people all the way from North Carolina Municipal Electric to Massachusetts Wholesale Electric saying the same thing: They can't sell bonds at these levels; the interest rates are too high. It's not saturation, it's a change in the fundamental mechanics of the market. That's what they have to deal with, and I don't think shifting to a short-term instrument that has to be rolled over will make their financing any easier or less expensive.

MR. VOGT: There are a number of questions that brings up, one of which is given that reality, how does one finance a long-term project today? How does one go about it?

MR. ATWILL: I would submit the financial consultant ought to be charged with selling that issue. That means doing some analysis as I spoke of earlier, but also going out and presenting what their whole, long term needs are going to be, what they're going to do, how they're going to do it, calendar when they're going to come to market and how they're going to pay for it. WPPSS has only really talked about the next issue and that list of participants. It hasn't really talked about the whole picture. It keeps changing the picture. Every prospectus that comes out has a different cost increase. WPPSS figures it won't do any harm to make worse case scenario a medium case scenario or an optimistic scenario. They'll present that to the investors and that will make it easier to sell the possibility of reselling bonds to the investors. The price that you pay in interest is largely determined by the risk that the investor thinks he's taking. If he doesn't know the risk, he has no choice but to charge you a higher rate. WPPSS has probably one of the best service areas, one of the most dynamic economies. There are a whole lot of positive things going for it. That sounds like the Chamber of Commerce, but if you want to quantify that, talk about it in dollar terms, I think you can make a case that these bonds represent a better value than almost any other regional power issue in the United States.

MR. VOGT: You mentioned that in your perception perhaps WPPSS had restricted itself in its kind of information it had obtained in terms of advice and so on, and I talked to Mr. Percoe in an interview back in early November about the balanced financing program, and just glancing through this here:

"Q You talked about other advisors you might have, like people within the state you might talk to about things you might be considering. Do you ever do that?

A Well, we do sometimes talk to the underwriters. I have had conversations with Merrill Lynch, Solomon Brothers, Smith Barney, Bache Halsey

Stuart, who are the four people who would have the historical record in bidding on the supply system issues. I know their principal individuals -- " etcetera, and then in regard to the balanced financing proposal, "We have talked to Smith Barney, who is the financial advisor for many of the client utilities that need to adopt this program."

Then I say, Can you give specific names, and he gives certain names, and then he says:

"A They would be the principal ones with those firms. We also have conversations with First Boston Company and other investment banking firms.

Q As to those ones that you mentioned, I assume that you talked to them at least about various aspects of your proposed, so-called balanced financing program. Have any of them ever expressed any opinion to you as to what they thought of that?

A Yes, they have all thought that the supply system ought to have some other alternative financing programs other than totally relying upon the long-term bond market. They have all expressed that we ought to be doing other financing mechanisms.

Q And specifically the ones that you have in mind now?

A Yes, and also the investors, too, have expressed this.

Q Have any of those people ever expressed any reservations about your specific plans?

A In what respect?

Q In any respect, saying I don't think you ought to do this, or you should be careful of that, or maybe you ought to do it this way rather than that way."

Well, I guess I started too early. Later on I say:

"Q I guess if I understand what you said, Mr. Percoe, you said those institutions are the institutions WPPSS should engage in short-term financing of some type.

A Some type as you determine of short-term financing. I don't want to put words in their mouths, but I feel confident that's what they would express.

Q How about any banks here in the state, commercial banks. Do you talk to any people?

A Yes, Don, due to -- particularly because of my close affiliation --" (He was formerly a municipal bonds person in Seattle banks) "-- I have many friends in the Seattle investment banking community and have discussed it with the banks, particularly Sea-First -- they think this is a good program -- and other firms as well.

Q Who would be the person at Sea-First?

A Tom Kubler.

Q And at some other banks.

A Some others? John Atwill at Rainier. That would be principally the banks. The other two are at Foster and Marshall and Northwest Securities who are two key firms we talked to about the program. They endorsed the program conceptually.

Q Any comments generally you would make about the underwriters would apply, in your judgment, to the banks and the investment companies in the State of Washington, too?

A Yes, sir. They might not have reviewed this in depth, you know, put somebody on it. We discussed it and left brochures, the same kind we talked about here, so they have had an opportunity to look at the program.

Q But generally this would be, I gather, oral advice."

Anyway, continuing; the impression I got from that interview was that you had endorsed, at least in general concept, their balanced financing program.

MR. ATWILL: I didn't get a copy of Blyth's proposal until last week. Jim has never talked to us about balanced financing. I can't say he hasn't talked to anybody -- I don't know but what he has -- but I can tell you from the conversations we have had from time to time that they tend to be very -- not very far ranging discussions, and as recently as February of this year, he asked me to put together a meeting in Seattle of investors and underwriters and traders of WPPSS bonds for the stated purpose of allowing him to learn some of the problems that would involve.

My opinion is that he didn't listen. Around that table was the suggestion that they put a moratorium on 4 and 5. His response was there isn't a chance that would happen. There was a suggestion that there was a real burden on the market by the amount of debt they were selling and that the rate was going to escalate, and that they would -- this group, particularly, the underwriters and creditors -- were losing enormous amounts of money on every one of the WPPSS deals. That was a period of time that followed, I think, three or four issues where the underwriters took significant losses on those transactions. People came to that meeting expecting that finally they would have a forum where they could tell Jim their feelings. It turned out that the forum was really for the purpose of Jim Percoe telling them what WPPSS was going to do, but it was not a dialog. It was a monolog. People left somewhat disgruntled.

You could walk into Seattle today and hear the kinds of things he quotes in there. Yes, people would endorse short-term financing. They'd do that because that would be easier for them to sell. I submit most traders and underwriters are looking maybe seven to eight days ahead and they're looking at what is most easy to sell today. I don't think they look at long-term ramifications of selling short-term debt, and the fact that that issue will be back next year with twice as much, the third year with three times as much, the cumulative effect of recommending that. In my conversations with him, none of those kinds of questions were asked. It was more, "If we had short-term debt to sell, could you sell it?" Yes, we could.

MS BROSTROM: At this same meeting, there were several underwriters who recommended -- that felt it would be advantageous if WPPSS had the ability to negotiate issues. Percoe pointed out that would require legislative authorization. He said they were unwilling to seek that; therefore, negotiated issues were out of the question. As it turned out, they didn't have to ask the legislature to do it; the legislature decided to do a study and it's coming about that way.

John mentioned the factor of saturation and the fact that it isn't necessarily -- the marketability problem of WPPSS is not necessarily due to saturation. However, at any given time coming into the long-term market may not be buyers of long-term bonds, so I feel it would very definitely be advantageous if WPPSS had the flexibility or at least some flexibility to respond to market changes that may require or dictate at any given time that there may be buyers in short-term, medium-term instead of long-term. I don't think that will solve the problem, the entire problem, without addressing some of the basic problems WPPSS has and the perceptions of the problems WPPSS has.

MR. VOGT: If I may paraphrase, what you're saying is that the long-range success of the WPPSS financing scheme will have to look to the long-term market at some point, sometime sooner or later, and that their ability to be successful in that market is a function, in part at least, of their ability to create a perception in the investment community that there is going to be a final amount of money issued; the plants will be completed; electricity will be sold, that sort of thing, that there is a king of uncertainty that any of this will ever come to fruition. Is that stating it correctly in a general way?

MR. ATWILL: The assumption I am making is that if you shift financing to the short-term market, and you have an accelerating amount of bonds to be issued, under their program, you've put off for a year, maybe two, the problems facing you. You'll saturate that so-called market, too, if you do that. You'll turn off every category of investor around, and in my opinion, that's not a responsible way to go, and WPPSS has to find a responsible way to finance these plants. Micki has said some bridge financing agreements with either banks or a consortium of investment bankers makes sense to get through a period of conceivably high rates so they don't have to come to market to do their financing there just because they don't like the long-term market prices. I don't think that is a responsible way of financing the plants, and I think most people would agree that the future users of power in the state are the ones or should be the ones who pay, not the current users. I guess I'm thinking what Jim's response would be. He'd say, "That's no problem." My opinion is that the market would not look favorably on that. Again, it's the Philadelphia-New York City-Boston syndrome where you are selling ever-increasing amounts of short-term debt to pay off maturing debt. Investors don't like that. They see it as a weakness, and it is a weakness. You're shifting more and more of your borrowing to a short-term market, and if you look at early-1970 to '80, some of the highest rates we have seen have been in the short-term market. The long-term market has been the place where an issuer should be selling his debt. That's where he got his lowest rates.

MR. VOGT: What do you think of the notion of requiring the participating utilities to raise their rates currently, to some extent, so that if you have a buildup of debt needs for the coming year, say, you get a couple hundred million of it out of the current year's rates and borrow the rest. Would anything along those lines have any bearing on the market perception of WPPSS's viability or commitments?

MR. ATWILL: The best answer is I don't know, but I think it would have very little effect. You really are diminishing the ability of those participants to increase rates in later years. A study would have to be made of the ultimate ability of participants to pay off all their debt. If the study shows they'll have to pay off some of the debt today, they ought to. My feeling is inflation will be with us for some time to come. The longer we delay raising rates, the better off we are going to be.

MR. VOGT: Yeah, but someday --

MS BROSTROM: It's like a snowball. Nobody knows how big it will get if you continue to postpone it. My feeling is if they were to pay down partially, say maybe even just the interest, from a marketing standpoint the street could perceive that as addressing the New York syndrome where they continue to roll over principal and interest. They are at least recognizing they can't simply postpone full payment indefinitely.

(A brief recess was taken.)

MS BROSTROM: (continuing) What I was saying was that if there were to be a partial paydown, at least of the interest, at the time of each rollover, that it would be a recognition of the fact that they could not postpone payment, 100 percent payment, indefinitely.

MR. ATWILL: Interest or principal? You said a partial paydown of interest. Did you mean interest or principal.

MS BROSTROM: Interest, not continuing to roll over the interest too, which was what got New York City in trouble. That would be a very modest rate increase, if any, just for the interest. At least that would address the problem that would concern a lot of investors.

MR. NEALE: About a year ago one of the brokerage houses, in the utilities newsletter, when WPPSS was considering refinancing some of the debt that was coming due which Bonneville was then going to pay, suggested that the refinancing scheme -- I'm trying to think of their words --

MR. VOGT: Subordinate debt program.

MR. NEALE: -- indicated reluctance on the part of WPPSS and the Bonneville Power Administration to test the willingness of the participants to raise their rates, which then suggested a weakness in the overall financing, I guess. That's partly where that question Don has is coming from.

MR. ATWILL: At that time there was enormous amounts of discussion. One of the major reasons was the way WPPSS went about getting answers to that question. It was not done in the press but was done in one-to-one conferences with investors. It came out that they were coming out with another subordinated issue -- that's a very bad word -- outstanding debt. Nobody knew what WPPSS was trying to ask. It was not well-defined; it was not discussed in any forums that were available. As a consequence, after several weeks

-- maybe months -- it got back to WPPSS that this was happening, and then they talked freely about what it was that they were trying to determine, and I can tell you that most of the investors I talked to were delighted that two of the participants held out and said, "No, you're going to have to raise rates," because it wasn't an indication, as you pointed out, that the system worked. Again, it was another indication of looking for a shortcut to a very difficult decision, and all the easy answers, really, were tried before; not the tough one, but really the only reasonable alternative. At some point, you have to do that. Why put it off?

MR. VOGT: One of the things WPPSS wants is this capacity to negotiate. I think Mr. Appel indicated in his judgment that would be a good thing for them to have. He suggested the possibility it could be conditioned -- and I guess as I understand why they really want negotiation is not so much to facilitate long-term sales, but these more creative short-term arrangements. So I guess what I'm gathering from what you're saying, it would be entirely appropriate if you do give negotiated authority to go into these short-term arrangements that you control that in some way so they aren't tempted to use that as the complete escape but that maybe if they can only be used short-term where you have a paydown, limit the amount, or somehow prevent them from taking the easy way out in dealing with their financial problems.

MR. ATWILL: Exactly.

SENATOR GOULD: Do you really believe that should be done by legislation? My response, always, to regulating somebody by legislation is that first of all it's always a compromise, anyway. You never get what you know is the right thing to get. Secondly, once you vote it in, it's almost impossible to change, but if it is changed, maybe it's changed the way you don't want it to be changed; and thirdly, if part of their problem is perhaps poor counseling, they need all the flexibility they can have to do what may -- should -- turn out to be the right kind of financing and if the market changes or the whole economic situation changes dramatically, here they are, stuck under laws that are more restrictive than they now have. I've found -- to me, and I was surprised -- you cannot legislate people into being smart.

MR. NEALE: There are some universal factors they should avoid that won't change.

MR. ATWILL: The market they're dealing in has changed. For years I was an advocate of the competitive sale. It does work. It gets the lowest price. The negotiated sale doesn't. It never has in this market, and it doesn't today. The underwriters will work for larger and larger spreads because they're not in competition to try and cut that particular cost. It seems to me if you're trying to build flexibility into WPPSS financing, I don't know what the best way to do that is. WPPSS certainly needs flexibility, as you say, because four years ago, our bank -- and probably 20 other banks -- went to WPPSS and said, "We'd like to offer you bridge financing, some kind of interim financing so you don't have to come to market as regularly as you've had to." This was before all the problems developed. Their answer was, "That's kind of a good idea. We want to, but we can't because we can't negotiate a contract with anybody."

Now, that's one of the balanced financing ideas that is still a good idea. I think that if it --

SENATOR GOULD: Negotiating is still a good idea?

MR. ATWILL: Negotiating a bank line of credit. The only way to do it -- no one bank can offer that financing. There isn't a vehicle where banks can form a syndicate and compete with each other offering -- Let me digress: When a bank makes a commitment to a large corporation saying, "Anytime you want to borrow ten million dollars, here you can borrow it at the prime rate," say they come on Monday to borrow the money. The same Monday the bank goes out into the CD market and acquires those funds at some rate, and then turns around and loans then to that person. The money isn't there all the time. But WPPSS knows these institutions or the institution needs to have -- has a requirement for -- tax-exempt income in order to make good on that line of credit, and it goes out and buys a CD as a source of funds. But if you don't need tax-exempt income, loaning it out to WPPSS at some formula less than prime may be a losing proposition. Banks, recognizing that, are not willing, by themselves, to go into competition with other groups of banks to offer something in the future that they may not need, so it's a complex problem and one that can only be solved -- I'm not pleading the bank's case; we need negotiations and should negotiate with the dealers, but I'm suggesting the fundamentals involved here make negotiating a bank line of credit an appropriate alternative to long-term financing at some times. I'm not talking about short-term financing of notes and rolling it over; I'm talking about bank financing which traditionally is specifically for a period of time to be paid off from some source of funds, whether it be increased revenues, rate increases, PUDs, bond issues, or some other source.

MR. VOGT: This is to tide them over for two or three months, something like that.

MR. ATWILL: Yeah. Traditionally bridge financing is during construction so that then the permanent financing is done when the construction is finished. WPPSS will be under construction for ten years. I'm not suggesting ten-year bridge financing.

SENATOR GOULD: I wasn't going to ask any more questions because I knew I would learn more by listening to questions from others. I have to be concerned about the political aspects of whatever we do. Two suggestions that may be made by a variety of legislators I'd like to have your opinion on as to the impact they may or may not have on your financing. One is this light brigade's proposal to put a limit on WPPSS financing, set a dollar limit on their costs, and if they went above that, they would have to have a referendum to the people of the state, which will be a piece of legislation with which we will have to deal one way or the other.

The other is in looking at the whole gamut of ways the legislature can attack the problem of management, WPPSS has had the suggestion of selling 1, 2, or all of the plants off to private companies. What kind of response would you expect to that type of action?

MR. ATWILL: My view of the light brigade is that that tactic is not one that would limit costs, but it would cripple the ability to generate nuclear power.

SENATOR GOULD: That's my view. Why would that happen? It's my job to be able to say.

MR. ATWILL: If WPPSS could come with a reasonable assessment of what it would cost to build these plants and could come to the legislature and say, "Here's the number. We'll be glad to go to referendum when we exceed that number," then that would be a positive limiting force.

MR. VOGT: What if it's 20 or 30 billion dollars?

MS BROSTROM: That would be a known. That's always better than an unknown. My feeling is that the electorate doesn't really have the knowledge to make that kind of decision. That's what we elect the legislature for. I think that could be utter disaster, and I also think it indicates a high level of frustration a lot of people are feeling by not knowing and not having access to the information, not have open hearings where they really know what's going on, what the long-range focus is. I think if you can respond with some mechanism where those concerns can be addressed, you won't have to -- there won't be the threat of the other.

SENATOR GOULD: I agree with you, but I have to back up my own arguments by saying, Well, if you did go ahead and do this, this might be what happens on the market. I don't know if I understand exactly what you mean when you say it would be disastrous. Are you talking about the market?

MS BROSTROM: Suppose these plants were 99 percent complete and there was another jump in cost, so there had to be a referendum, and everyone said no. What then? That's the point I'm making.

SENATOR GOULD: Will the market be affected in anticipation of that possibility?

MS BROSTROM: It could be. If factors beyond the control of the experts could influence whether or not there was ever an operating plant, that could affect the market very substantially, and investor confidence.

MR. ATWILL: We have that now. Anytime you have a nuclear referendum in any state, it affects any nuclear facility. Referendums in this state don't come close to passing. Certainly the one in Oregon and the one in California has come close to being effective, so that influence on WPPSS is already there.

MS BROSTROM: There have been instances where trading in certain issues has been suspended, because they couldn't get a bid on bonds where there was a very strong threat of some kind of curtailment.

SENATOR GOULD: What about the second question? I don't know if it's a real possibility but it's certainly something to think about; that is, the sale of the plants off or the stripping of the Washington Public Power Supply Systems of —

MS BROSTROM: When you have a possibility of private companies building additional plants, I think it's probably a good idea, to at least be able to do it. I can't see any objection to it at all.

SENATOR GOULD: From a financing point of view?

MR. ATWILL: Though I don't think it accomplishes a lower rate for users, perhaps it would be a way of getting WPPSS good management.

SENATOR GOULD: I'm interested in hearing about that. My thought was what if nobody wanted them.

MS BROSTROM: Then you'd have problems. I'd like to reiterate again -- as Bill Appel did also in his testimony -- that there is no perception on the part of investors that there is not the ability to pay. That's not a question. It is simply the market vulnerability. People don't like to make investments where there's a 99 percent certainty the value will be down. That's what people object to.

I'd like to respond to something you commented about when we were talking about the requirement for legislative action in order to be able to negotiate issues or for short term financing. You were concerned about passing legislation that would allow that, but not being able to legislate how it was used and intelligence, as you said. I guess my feeling is that if that were to be authorized by the legislature -- and I think Bill Appel intended to say this also -- that it should be part of a total package, along with probability studies or analyst consideration or some sort of independent board that could act as a liaison between the legislature and WPPSS, that theoretically would have the ability to hold hearings to get public input on financing and the investors' perspective and on other factors where there apppears to be a gap in the information flow.

SENATOR GOULD: Thank you.

MS BROSTROM: There are ways that could be addressed without specifically legislating each specific action.

SENATOR GOULD: That gives you the flexibility.

MR. VOGT: I wanted to pursue a little more

Mr. Patterson's remarks here. He says:

"A If for some reason they're not constructed, I think that will be one of the most negative things that can occur for the Northwest Region, not just for the energy picture, but for the perception of credibility.

I don't know if you're familiar with the Urban Development Corporation of New York. That didn't have to occur. In my opinion, that occurred because of a lack of sophistication of the legislature. Governor Carey's advisors didn't realize what they were doing and that the reaction of the financial community would be that they were totally inept. Some of them probably had no experience in that financial environment. The states of Massachusetts, New Jersey, Pennsylvania and New York paid penalties as a result. All had peculiar problems. Some were similar.

We have the same problem here with four and five. For WPPSS -- it's not just WPPSS, it has to be looked at in the context of the State of Washington -- being the largest issue of date in the State of Washington, if the posture of WPPSS in the financial community is positive, it will have a positive effect on the state and its credibility, if the supply system is a success. If the supply system does not regain credibility and its credibility is lost in the financial community, if something happens to projects four and five, the impacts are, at this time, immeasurable on a negative basis for the region. It would have an impact on the State's debt, on the members, impact on the economic environment of the region.

Q Where would the impact come from?

A The impact would be primarily the lack of energy, one. The projects being used in the Northwest are being questioned because of low growth, based on whether the growth is on the low side. But from an institutional point of view, if you lose a commitment to something, and you have an institution or entity paying for something it does not receive, it has to buy that commodity it is already paying for. It has a double impact. It's a double negative that it's going to have. I would say it's going to raise serious questions of whether the utilities have the financial wherewithall to accomplish both options. Looking at the resources available to each region, the only one with viability in relation to --", and then he says the viability we are looking at is conservation. Then he goes on to talk about Seattle's movement toward conservation, that it has hurt Seattle a lot with the institutional market and buyers generally.

Then he says:

"A I think that anytime you have a major entity of the State terminate a large financing program, that it has an economic impact effect on the state. It's a fact of life we would have to prepare for in terminating projects four and five."

So anyway, that is his perception of that, and I wondered how you would see that.

MR. ATWILL: Everywhere he said "it is," I would say, "it may be." Certainly that can be the effect. I don't think you can compare the possibility of a moratorium on four and five with the New York urban development situation. Those are two entirely different situations, two entirely different regions trying to serve entirely different needs. It is my opinion that if the decision was made to put a moratorium on two plants or five plants, it would be based on some fairly sound judgments and that wouldn't be a negative; it would be a positive.

Obviously, one of the factors in making that decision would be, Where are you going to get the power that's needed; what will be the source; what will be the burden on the participants. Presumably, if they decided to cancel these plants, it would be cheaper to get power elsewhere. In any case, it would be cheaper to stop construction today in terms of the next 40 years. In terms of not getting power and increasing the rates that are going to have to be paid, I basically disagree with his assessment. I certainly disagree with his assessment of the market perception of Seattle. I would suggest that many market participants don't understand what Seattle did, and most recently his opinion has flopped over into one of praise for Seattle, to "Look at what they've avoided in four and five." Seattle has other sources of electrical energy. Certainly that was one component. In fact, they said they could do without participation in four and five. Still, maybe down the road, they will regret that decision. They had that option. Snohomish PUD did not have that option. They made the same decision. They have to say, "Okay, maybe that wasn't the wisest decision."

The other thing he touched on that I think is an important point is conservation. In this state, there is no economic incentive to conserve power. That probably has to be a component in this study I'm suggesting WPPSS carries out. If you're going to talk about the elasticity of demand, you ought to be talking about conservation as a component of that. If these people demonstrate some effort in the conservation of energy, they should receive an economic benefit. Those who don't should pay the full freight. We don't have that cranked into the rate system right now, and until we do, I think we'll have economic problems in satisfying the energy demand of this region.

MS BROSTROM: Mr. Patterson's firm is paid by WPPSS and is paid on a fee basis on each issue WPPSS sells. Obviously, if they discontinue any projects, that means less bonds issued and less fees paid, and I can't conceive of any circumstances under which he would be recommending that one, two, three, four or five plants be curtailed, so I think his position is completely understandable.

He's making two assumptions which I think may have been valid two years ago, but not necessarily today. One is that the demand is there for all of the power these plants will be generating. The other is without that power we are going to experience brownouts and, in some cases, complete outages. We don't know that for a fact anymore. That's another thing a study could show, Is there still that demand or are there going to be alternative methods available, including conservation, that will curtail that demand.

MR. HUSSEMAN: Maybe you commented on this when I was out, and if so, I'll read the record, but early in this discussion, you stated that there were a lot of subtleties between competitive sales and negotiated sales. Since we're probably going to be faced with that issue in this process, I wonder if you could describe those subtleties.

MS BROSTROM: In a competitive sale, the underwriters prepare a bid, which is a confidential bid up until the time it's submitted and opened. Everybody is bidding on exactly the same thing. The issuer defines the terms and conditions of the bonds he wants to issue, the amount, the maturity schedule, the call feature, the maximum interest rate in most cases so everybody is bidding in conformance with the same set of rules on the same issue. The underwriters determine where they think they can sell, what it would be profitable to sell for and make the bid accordingly. They're submitted and opened, and it's a rather simple procedure to tell who the low bid is.

In a negotiated issue, the underwriters selected by the issuer work with the issuer in structuring the issue. At the same time, they are working with the investors to determine what the investors want so it can be tailor-made for the investors at the time you're also selling the issue. In a competitive deal, the underwriters have to make the determination as to wher.

they think they can sell it and hopefully, they're right and they make a profit. In a negotiated deal, they can work with the issuer on one hand and the investor on the other to come up with something that is mutually acceptable. You don't have that flexibility in a competitive deal.

MR. ESCHELS: In one of the hearings there was a perception on someone's part that in a negotiated bid your market is assured; you have a firm market once you go into it. On the competitive bid, I have a little experience as a retailer for Merrill Lynch, so I know about market indications. Is that still true that in the negotiated market you have a firm demand?

MS BROSTROM: You have a better opportunity to get a better idea of what the demand is.

MR. ESCHELS: But the bonds can't be presold.

MR. ATWILL: You have a wider period of time than in a competitive deal. Let's say in a competitive deal the sale is on Wednesday. On Monday you go out and try out prices on your investors. They say no, so you say, "We'll try a better price," so on, so forth. So the sale date arrives, and at the sale date, you go and give your bid. If you're the successful bidder, you turn around and go back and sell the bonds.

In a negotiated deal, you start Monday, and this guy says, "I won't buy them here; I'll buy them there," so on, and finally you've got all these orders in your hand. When you go in to talk to the issuer, he says, "No, I won't sell at that price," so you go back and talk to the buyers, and there's this back and forth between the issuer and the investors. The time period is stretched to allow for the broker who is in between. His risk is diminished because he's fine-tuning exactly what the issuer will do, what the investor will do. We've seen instances where they come out with preliminary pricing and when they go out, the issue is oversubscribed ten times, so then they reprice it, obviously at higher prices, and maybe when 90 percent is gone they say, "Well, I think we can sell the other 10 percent," so they go to the issuer. They say, "This is the price we'll pay," and the issuer says yes, so that bid is confirmed for 90 percent of the bonds and only 10 percent is sold at less. The degree of certainty is far greater in negotiated sales if there is time to negotiate between the issuer and the buyer.

MR. NEALE: You'd have to be a lot more sophisticated in the analysis of what to accept in the negotiated sale, wouldn't you?

MR. ATWILL: Who?

MR. NEALE: The issuer.

MR. ATWILL: Yes, I think they need independent counsel to advise whether that is market rate. That's why I like a competitive sale. You're assured of getting some kind of assessment of what at least two bidders or three bidders will pay.

MR. HUSSEMAN: What if there's only one bidder?

MS BROSTROM: In a competitive sale, you're working generally with smaller issues and you can have two, three, four or more bidding groups. In negotiated issues, negotiation is really more beneficial when the issue is so large, or where there is only one bidding group, and you don't have the distribution to be able to put together two or three separate systems to make these separate bids.

MR. NEALE: What about the statement that if under the current arrangement WPPSS can negotiate a sale after a rejected competitive bid that, as WPPSS people tell us, this telegraphs the interest rate and redetermines your boundaries, the floor, mainly, for the interest rates, terms and so forth? In a volatile market, does rejecting a bid and then coming out and negotiating still have that loss in competitive edge?

MR. ATWILL: Not really. What happened was that they did this at a time when there was a marked improvement in the market between the time they rejected the bid and the time they negotiated it.

MR. NEALE: They say they got it for two-thirds of the drop in the overall interest costs.

MR. BROSTROM: That's probably about right.

MR. ATWILL: Another thing, in a negotiated sale with someone like WPPSS coming into the market frequently, it's fairly easy to determine -- if they've negotiated at 14 percent, let's say, it's pretty easy to determine by what the bond is selling at two days later whether they got the lowest rate or not. They can't factor that in because it's too late on that issue.

MR. NEALE: How would you know the next time that wouldn't happen?

MR. ATWILL: I think independent counsel is somebody that's more and more frequently going to be hired. We're seeing that informally now.

MR. NEALE: Does their claim hold up that a first offering sells competitively and then rejecting it to go to negotiations causes prejudice on the market?

MS BROSTROM: I think it does, in that the investor perceives it as a negative. "They couldn't get any bids; therefore, they had to negotiate." It's sort of -- Well, it doesn't put it in a positive context.

If there is a negotiated issue because we feel we can get the best rates that way, there is the feeling, "WPPSS had to reject all the bids; They didn't get all the bids, therefore they have to negotiate," and in a certain sense, it does telegraph what the rate was that they turned down.

MR. NEALE: Even in a highly volatile market?

MS BROSTROM: Yes.

MR. HUSSEMAN: There was some more testimony in which a WPPSS board member, in requesting the legislature to consider the negotiated bond sale amendment, said -- well, as an example, he said -- "On our last bond issue, we paid 11-plus percent. If we could only go to negotiated, we could maybe have gotten eight or nine percent." I'd like your comment on just how much you really can save in the way of an interest rate between going competitive and going negotiated. What is realistic?

MR. ATWILL: He was suggesting that by negotiating he would have had a lower rate of interest?

MR. HUSSEMAN: He was talking eight percent.

MS BROSTROM: What was he basing that on?

MR. HUSSEMAN: His testimony, as I recall, was that he thought if they could have negotiated that last bond issue, which went out at 11.6 or whatever it was --

MR. VOGT: 10.6

MR. HUSSEMAN: -- that they could have got something in the area of eight or nine percent.

Do you guys recall that testimony?

MR. ATWILL: He may have been referring to the fact that after that sale, the market in general improved, and those bonds were selling at a premium with yields at nine percent, which would suggest if he waited for a competitive sale for two or three weeks, whatever he was talking about, the competitive sale would have shown that lower rate. That's the only circumstance that -- I don't believe there's that much difference between investors who buy from a negotiated sale and those who buy from a competitive sale that there would be that kind of savings.

MR. HUSSEMAN: Interest rates are about the same whether competitive or negotiated?

MR. ATWILL: The difference is what the profit margin is for the underwriter.

MR. PEPE: So the advantage is for the underwriter, as opposed to WPPSS.

MS BROSTROM: The price on the bonds --the interest on the bonds will still be determined on the basis of what other instruments are available to the market.

Sale is based on what is available in the secondary market, what other issues are selling. There is some spread differential accounted for in the profit for the underwriters, but that is not the primary determination of the rate on the bonds. It is still a money market instrument.

MR. ATWILL: You're talking about differences of half a percentage point. That would cover the spread.

MR. HUSSEMAN: What are the advantages or disadvantages of WPPSS, as the issuer, in going to negotiated bond sales?

MR. ATWILL: Primarily the flexibility on the point in time when you enter the market. If you announce a sale for January 15, you have no idea what is going to be happening that day. There's nothing to negotiate. If you announce, "We'll sell it sometime in January --". I think the classic example of that would be the IBM issue in late 1979 just before the October 6 federal action. Solomon went to IBM and said, "You should come to market today. We see a very short time before tremendous increases in rates." They did, and it was the classic story: They sold a billion dollars in debt and by January 1 there was a quarter of a billion dollars in losses for those people that owned it.

MR. HUSSEMAN: So the advantage to WPPSS is more flexibility in when and I guess the size of the issue.

MR. ATWILL: WPPSS has to come on a regular basis. Say the underwriters could come to WPPSS and say, "Come to market today because we think there will be things happening in the next five days," you could accelerate your sale maybe ten days, something like that. You can't do that on a competitive sale. You're forced to borrow on the day you announced you'd accept bids.

MR. HUSSEMAN: What are the disadvantages to WPPSS?

MR. ATWILL: On a negotiated sale?

MS BROSTROM: You're dealing with only one bidding group, which they are anyway.

MR. ATWILL: In this market environment, there is not much of a risk. In a period of slow market growth, lower interest rates, there probably would be a savings over the life of an issue of two or three million dollars in interest on a 120 million dollar issue. The difference between a first and second bid can be two to three million dollars in interest.

MR. PEPE: Do you think it would be realistic to structure a system where negotiated bids were trigg[illegible] by the exceptional case. Where you had an exceptional case you could define, negotiated options would be available, or is that --

MR. ATWILL: That is subject to interpretation. You would probably muddle your competitive bids. People would not know whether you'd get within five days and all of a sudden something was triggered and you went out and negotiated.

MS BROSTROM: If you put the burden on WPPSS to know what the market conditions were at any given time, to anticipate or try to anticipate what they would be to determine which way to compete, that would not be fair either.

The advantage of the negotiated issue is the ability to fine-tune. Under the present system, WPPSS is required to essentially set the terms of issue, say, 30 days or two weeks in advance. For a competitive sale, you have to determine the amount, basically, the call feature, all that data. You could get into a situation where, based on those parameters, you didn't get bids. Negotiation allows you to fine-tune on the timing and parameters..

MR. PEPE: Is there an objective measure, if the secondary market was doing that on the sale of a negotiated bid, that would indicate when negotiated sales were not producing favorably compared with competitive bidding? Would there be something that would be a measure that would cut it off?

MR. ATWILL: Looking from the standpoint of the underwriter, whether it's a negotiated or a competitive bid, he would rather sell in a market environment where it's easier to sell. That's why I would advise that you have some kind of independent counsel that will say, "Why don't you wait," because the negotiater, when he comes in, will say, "Let's sell it today," because he can sell it more easily, and WPPSS might be better off to wait. It can go both ways. There's no hard and fast rule as to the advantage to the underwriter and the advantage to WPPSS. That's why over a period of time, competitive sales will work to the advantage of both about equally. There's a lot more risk to the underwriter. There's a risk on rate to WPPSS.

MR. VOGT: I gather that you feel that a study of some of the components, at least, along the lines Mr. Appel recommended would be an authoritative way to indicate what the total cost is and the market rates required to repay that to ensure a sufficient amount of electricity and would have a positive impact on the whole WPPSS financial situation because of this uncertainty problem.

MR. ATWILL: I'm certain it would because of conversations I've had with other investors. They don't have the resources to go out and do that study themselves, and it's that degree of uncertainty that is translated to risk and demand for a higher rate of return when loaning money to WPPSS. I think a positive from that standpoint is that it would also give WPPSS a lot better idea of what their answer is.

MR. VOGT: Assuming that study shows the power is needed, they should go ahead, all that sort of thing, your basic suggestion is that WPPSS more or less bite the bullet and pay long-term rates for long-term money?

MR. ATWILL: Yeah. I wouldn't try and --

MR. VOGT: I meant there may be short-term things, lines of credit, or something to get them over the short term --

MR. ATWILL: Some sort of balanced financing where they suggest financing of fuel and financing some other short term assets that the system is buying, sure, that would be appropriate.

MR. VOGT: But in general it's a long term project, and they should look to the long-term market for that kind of money.

MR. ATWILL: Look at any buyer that stayed in the commercial paper market instead of investing in long-term hardware. I can't believe that if he had the decision to make over again, that he would make that one. Who knows what the most advantageous rate is? You know you have a forty-year project, so you have to match your borrowing to the useful life of the project.

MR. VOGT: Looking over Mr. Patterson's interview again, he was talking about rolling over the short-term obligations maybe until 1990 when presumably a couple plants are on line. You then don't have four and five long-term issues competing with one, two and three long-term issues and so on. What would be your perception of the market's perception if WPPSS -- which it voted yesterday at the board of directors meeting to ask all 88 participants to authorize some form of balanced financing program. By the way, we need the final draft of the form of the supplemental agreement that would spell out the limitations on short term financing and so forth -- but what would be your perception of the market perception of, "We'll go into short-term financing. We'll issue so much each year of short term through maybe some kind of commercial paper secured by a bank line of credit, secured by a pledge of the utilities to raise their rates within 14 months or something if it can't be rolled over; otherwise roll the short-term money over for the next ten years." What would be your idea of the market's perception of that?

MR. ATWILL: Initially there would be a favorable response, but if you encountered construction delays or increased costs, it would be very difficult to have these people with debts maturing, to get them to re-invest. That's your liability. The other thing, in my opinion, is that the capital market is putting off the day when some permanent investment in capital assets has to be made. If you don't stop financing that short term market, if you add WPPSS to that agenda and try and finance all of it, in 1990 the rate could be astronomical. Again, I'm suggesting that there is a supply-demand equation that operates in the capital markets and that right now the supply of long-term bonds would seem to exceed the demand for them, but there still is a market ou there. That market has a rate of interest that is less than any short-term debt you carry today.

MR. VOGT: So I want to pursue this one point. You say there is this deferred need for --

MR. ATWILL: An awful lot of plant and equipment is being financed in the commercial paper market or taking down bank lines instead of permanent financin that would match that capital improvement such as a plant or a new assembly line, machine, or something like that.

MR. VOGT: Why is that being done now?

MR. ATWILL: Their perception is -- they're betting rates will come down. They're making that bet now, and in four or five years --

MR. VOGT: The bigger the snowball is, the less likely that the rates will ever go down, because they'll all, at some point, decide they won't go down and then they'll hit the long-term market. Is that the point you're making?

MR. ATWILL: Right. The day before yesterday Southwest Bell Telephone sold a 40-year issue at 14 and three-eighths, I believe, 14 and a half. Henry Kaufman consultant for Solomon Brothers is suggesting it will sell at 16 percent a year from today, so I guess I would agree with him that inflation is something that will be around for this decade, and the supply of debt is just going to grow and grow and grow until some of the people are forced into the long-term market. I hate to see WPPSS join the people borrowing short-term and putting off that day. I think that would be the wrong thing to do. One fundamental I think you'll find everybody in the investment banking community saying is, "Don't try to pick a time to borrow money; borrow money for the period of time you need it. Over time you'll come out right." If WPPSS was trying to finance a billion dollars and that was it and it was out of the market forever, I'd say, Fine, go short-term. If they have to borrow twice what they have outstanding by monkeying around with short-term debt and then having to roll it over -- you talk about clogging the market, that's a sure-fire way to do it.

MR. VOGT: Maybe there's something we should have asked but didn't. Is there some other comment you want to make, something we ought to be looking at?

MR. ATWILL: As far as I'm concerned, you've covered all the points I felt needed to be addressed.

MS BROSTROM: One article in the Wall Street Journal you may or may not have seen is the November 26 article that Virginia Electric Power had done a study, and on the basis of that study, they decided to shut down one of their projects, and Solomon Brothers was mentioned as having reviewed it. I called a friend at Solomon to find out who did it, and it was either EBASCO or Stone and Webster. Essentially it was the same kind of study Bill Appel was talking about, a probability study of the likelihood of completion or operation. I noticed EBASCO is also under contract to WPPSS.

MR. HUSSEMAN: Probably Stone and Webster, too.

MR. VOGT: Stone and Webster produced a study that showed that the then-scheduled 12 billion, nine hundred million dollar budget was adequate to carry the plants through to completion, provided certain management action was taken. Four months later the WPPSS board announced the new budget at four-plus billion dollars more than that scheduled. Did Stone and Webster miss something, or did the board miss something?

MS BROSTROM: If all Stone and Webster was asked to do was verify what WPPSS had already come up with, it's logical they would come to that conclusion.

MR. VOGT: I'm just joking since the name came up.

MS BROSTROM: It was mentioned earlier I think that the possibility or the likelihood of finding an independent firm to conduct this study might b impossible. It very well could be, but it has to be made.

MR. ATWILL: If there is such a study, some independent groups could be hired to do components of the study. If you turned it over to Stone and Webster or EBASCO, the nuclear industry would be very incensed, because they're properly considered more a a part of the investment community.

(Whereupon at 1:30, the interview was concluded.)