Minnesota Public Utilities Commission

Staff Briefing Papers

Meeting Date: April 23, 2015 .... Agenda Item No. _3**_

Company:	Greater Minnesota Gas, Inc. ("GMG" or the "Company")
Docket No.	G-022/S-14-1051
	In the Matter of the Petition of Greater Minnesota Gas, Inc. for Approval of 2015 Capital Structure and Permission to Issue Securities
Issue(s):	Should the Commission approve GMG's request for approval to issue securities?
	Should the Commission approve GMG's proposed capital structure and capitalizations?
	Should the Commission require GMG to file additional information?
	Should the Commission place any conditions or requirements on an approval of GMG's request?
Staff:	Clark Kaml.. 651-201-2246
	Ganesh Krishnan 651-201-2215

Relevant Documents

Greater Minnesota Gas Petition .... December 22, 2014
Department of Commerce ("Department") Comments .... March 06, 2015
Greater Minnesota Gas Reply Comments .... March 16, 2015

The attached materials are workpapers of the Commission Staff. They are intended for use by the Public Utilities Commission and are based upon information already in the record unless noted otherwise.

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Printed April 13, 2015

Issues

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Should the Commission place any conditions or requirements on an approval of GMG's request?

Procedural History

On December 22, 2014, Greater Minnesota Gas filed a petition requesting Commission approval of its proposed 2015 capital structure and permission to issue securities ("Petition").

On March 6, 2015, the Department filed comments recommending approval with modifications.

On March 16, 2015, GMG filed reply comments.

Relevant Statute

MINN. STAT. § 216B.49

Subd. 3 states:

It shall be unlawful for any public utility organized under the laws of this state to offer or sell any security or, if organized under the laws of any other state or foreign country, to subject property in this state to an encumbrance for the purpose of securing the payment of any indebtedness unless the security issuance of the public utility shall first be approved by the commission. Approval by the commission shall be by formal written order.

Subd. 4 of the same statute states:

Upon the application of a public utility for approval of its security issuance and prior to the issuance of any security or the encumbrance of any property for the purpose of securing the payment of any indebtedness, the commission may make such inquiry or investigation, hold such hearings, and examine such witnesses, books, papers, documents, or contracts, as in its discretion it may deem necessary. Prior to approval the commission shall ascertain that the amount of securities of each class which any public utility may issue shall bear a reasonable proportion to each other and to the value of the property, due consideration being given to the nature of the business of the public utility, its credit and prospects, the possibility that the value of the property may change from time to time, the effect which the issue shall have upon the management and operation of the public utility, and other considerations which the commission as a matter of fact shall find to be relevant. If the commission shall find that the proposed security issuance is reasonable and proper and in the public interest and will not be detrimental to the interests of the consumers and patrons affected thereby, the commission shall by written order grant its permission for the proposed public financing.

Party Positions and Recommendations

GREATER MINNESOTA GAS

Greater Minnesota Gas is a wholly-owned subsidiary of Greater Minnesota Synergy, Inc. (“GMS”). GMG does not issue its own securities, it receives its equity in the form of equity contributions from its parent.

On December 19, 2014, GMG filed a petition for approval of its 2015 capital structure and permission to issue securities. The Company is requesting:

Approval of its proposed 2015 capital structure;

Approval of a total capitalization of $35.5 million;

Approval of its proposed contingency ranges for its equity ratio, short-term debt ratio, and total capitalization contingency of $1.9 million, or 5.5 percent;

Approval of an equity ratio of 31.66 percent and an equity range of 31.59 percent to 38.61percent;

The ability to issue short-term debt not to exceed 10 percent of total capitalization while the 2015 capital structure is in effect;

Approval to issue securities provided that the Company’s capital structure remains within the requested ranges;

The flexibility to issue long-term debt provided that the Company remains within the equity and short-term debt contingency ranges and does not exceed them for more than 60 days; and

Approval of the 2015 capital structure until the Commission issues a 2016 capital structure order.

The Company's current and proposed capital structure is:

GMG's Capital Structure

	Actual October 31, 2014		Projected December 31, 2015		
	Amount	Percent	Amount	Percent	Difference
Common Equity	9,138,601	31.56%	10,647,652	31.66%	1,509,051
Short-Term Debt	1,394,102	4.81%	1,182,000	3.51%	(212,102)
Long-Term Debt	18,420,727	63.62%	21,799,227	64.82%	3,378,500
Total Capitalization	28,953,430	100.00%	33,628,879	100.00%	4,675,449
Contingency			1,871,121	5.56%	
Total with Contingency			35,500,000	105.56%	

Department Comments

The Department's comments included analysis that is not repeated in these briefing papers. The Department recommended that the Commission approve GMG's Petition with modifications.

Compliance

The Department indicated that the Company has complied with Minnesota Rules and the Commission's Order in Docket E,G999/CI-08-1416. The Department noted that Commission's Order in Docket G022/S-13-1169, GMG's 2014 securities issuance (or capital structure) docket, requires GMG to provide the following information within 20 days of each non-recurring issuance of securities:

1. The specific purposes for individual issuances;
2. The type of issuances;
3. The timing of issuances;
4. The amount of issuances;
5. The issuance costs; and
6. Interest rates.

The Department stated that GMG's Petition identifies three new loans issued during 2014. One is a renegotiation of an existing loan, and two are new loans totaling $4.9 million. These loans are reflected in the financial statements included in GMG's monthly compliance filings in Docket No. G-022/S-13-1169. However, GMG did not report these issuances to the Commission as required by the Commission's Order in the 2014 Capital Structure Docket.

In response to Department Information Request No. 8, GMG stated that these loans were not securities, but rather were conventional bank financing, implying that GMG was not required to report these loans to the Commission.

The Department argued that:

1. Minn. Stat. § 216B.49, subd. 1 defines the term "security" broadly.

2. Commission's March 15 Order in Docket G-022/S-12-1370 (the 2013 Capital Structure Docket) required GMG to interpret the Commission's reporting requirements broadly in determining which financial transactions are reportable securities issuances in the future.

The Department concluded that GMG should have reported these transactions to the Commission.

Department Analysis

The Department indicated that it understands that GMG does not plan to take actions specifically intended to increase its equity ratio during the next three years. While GMG's ability to lower its average cost of debt has had significant, positive effects on its financial performance, GMG is and will continue to be heavily leveraged for the next few years. If interest rates rise, and GMG is forced to refinance its debt at higher interest rates, the Company will be at risk of seeing its interest coverage ratio fall to the low levels seen between 2010 and 2012.

The Department stated that if GMG were to allow its equity ratio to rise, regardless of whether interest rates increase, GMG's lessened reliance on debt will help protect the Company from finding itself unable to make its debt payments. GMG's aggressive expansion in the short- and medium-term could turn out to be better for GMG's long-term financial health than a more conservative expansion plan. However, in the short and medium terms, GMG's aggressive growth plan is riskier.

The Department noted that in Attachment 3 to the Petition, GMG requested approval of a capital structure with a 31.66 percent equity ratio. The Department stated that GMG's projected equity ratio is derived with a calculation that excludes amounts drawn on the Company's line of credit, which should be included. After adjusting for these amounts, GMG's proposal appears to reflect a capital structure with an equity ratio of 31.15 percent, which is below the proposed floor of 31.59 percent.

The Department stated that GMG's current and proposed equity ratios are significantly lower than the average equity ratio of risk-comparable gas utilities. The year-end 2013 average equity ratio of publicly traded gas utilities with bond ratings from BBB- to A- was 48 percent. The Department remains concerned about the financial health of the Company, and does not recommend that the Commission approve GMG's projected capital structure with an even lower equity ratio.

The Department recommended that the Commission approve the alternative capital structure shown below, in which the Department adjusted GMG's projected short-term debt to achieve an equity ratio of 31.59 percent, the minimum of GMG's proposed equity ratio range, as described on the next page.

Department Alternative Capital Structure

	GMG Proposed Capital Structure December 31, 2015		Department Alternative Capital Structure December 31, 2015		Difference
Common Equity	10,647,652	31.15%	10,647,652	31.59%	-
Preferred Equity	-	0.00%	-	0.00%	-
Short-Term Debt Line	550,000	1.61%	75,000	0.22%	(475,000)
Current Portion of Long-Term Debt	1,182,000	3.46%	1,182,000	3.51%	-
Total Short-Term Debt	1,732,000	5.07%	1,257,000	3.73%	(475,000)
Long-Term Debt	21,799,227	63.78%	21,799,227	64.68%	-
Total Capitalization	34,178,879	100.00%	33,703,879	100.00%	(475,000)
Contingency	1,871,121	5.55%	3,370,388	10.00%	1,499,267
Total with Contingency	36,050,000	106.96%	37,074,267	110.00%	1,024,267

The Department stated that it recognizes GMG's continued financial improvement in 2014. However, the Company remains in a precarious financial position. The Department supports GMG's intentions to add profitable, high-volume customers to its system. However, as long as the Company continues its aggressive expansion plan, financed in large part with new debt, the Department recommended continued scrutiny of GMG's capital structure through monthly compliance filings.

Recommendation

The Department recommended that the Commission:

Approve the Department's alternative proposed 2015 capital structure, as shown in Table 6 of its comments;

Require GMG to file a new securities issuance and capital structure petition by January 1, 2016;

Approve an equity ratio contingency range of 31.59 percent to 38.61 percent;

Require that GMG maintain an equity ratio contingency range of at least 31.59 percent at all times;

Require GMG make monthly compliance filings on or before the 15th of each month containing a balance sheet, income statement, and cash flow statement for the first of the prior two months, demonstrating that its equity ratio is at least 31.59 percent, and require the Company to include amounts drawn on its line of credit in its short-term debt total;

Approve a short-term debt contingency cap of 10 percent (i.e., GMG's short-term debt is not to exceed 10 percent of its total capitalization, including the contingency, for more than 60 days);

Approve a total capitalization contingency of $3.4 million above the estimated 2015 year-end total capitalization of $33.7 million, for a total capitalization of $37.1 million; and

Direct GMG to provide the following information within 20 days of each nonrecurring issuance of securities, including conventional bank financing:

(1) The specific purposes for individual issuances;
(2) The type of issuances;
(3) The timing of issuances;
(4) The amount of issuances;
(5) Issuance costs; and
(6) Interest rates.

GMG Reply Comments

General Response

In its reply comments GMG stated that it does not generally object to the Department's recommendations. However, it requested that the proposed modified calculation method be stayed for one year.

GMG stated that it did not withhold information regarding loans. The information was provided in a variety of ways including information regarding various bank proposals, timing of issuances in its 2014 capital structure filing, and information request responses. GMG indicated that it also filed monthly financial statements disclosing its debt placement.

GMG agreed with the Department's comment that its growth is only marginally helping financial performance. GMG explained that its main extension policy is based on the concept that old customers should not be obligated to subsidize service to new customers and new customers should not be required to subsidize old customers. GMG's main extension policy attempts to balance equal contribution from new customers being added to the system with that of previous customers.

GMG noted that it has added personnel in operations management, engineering, field staff, customer service, financial reporting and regulatory arenas. These investments provide a long-term payback rather than immediately visible cash flow benefits.

Short Term Debt

GMG requested that short-term debt not be included in its capital structure calculations for one year. GMG stated that it does not object to the Department's suggestion that short-term debt be included in its equity ratio calculations in the future. However, since GMG did not plan for that change in developing and planning its 2015 capital projects, instituting that requirement immediately will likely preclude GMG from providing service to some new areas this year.

GMG explained that its line of credit is driven by the increase in customer numbers and the related accounts receivable. GMG pays for the natural gas used by the customers before it receives payment from those customers. The projected increased in accounts receivable from October 2014 to December 2015 is approximately $1 million.

If the inclusion of the line of credit in calculating its equity ratio is not stayed for one year, GMG will need to reduce its capital projects and will not be able to serve consumers who do not currently have access to natural gas. GMG claimed that its increase in volumes between 2012 and 2014 directly benefit Minnesota consumers by approximately 7.8 million dollars per year in lower energy costs. It argued that the energy savings directly correlates to improved economic activity for the communities that are now served by natural gas, including the intangible benefit of being more marketable to commercial community participants. A reduced growth would deny access to energy cost savings to thousands of unserved Minnesota customers.

Additional Equity Financing

GMG claimed that by providing the tools to raise additional equity, GMG, the Department, and the Commission can cooperatively adopt a strategy that will continue to benefit rural Minnesota areas. It noted that its investors have been providing capital to the company for up to twenty years without any return on their investments. GMG proposed that the Commission order it and the Department to provide a five year capital plan in GMG's 2016 capital structure filing. The plan would include minimum equity ratios required for GMG and the terms under which dividends could be paid to GMG's shareholders. It argued that a five year capital plan will provide more predictability for the Department and the Commission regarding GMG's capital structure.

In addition, it would allow GMG to provide its shareholders a sense of when they can expect to obtain some return on their investments. That, it argued, will help GMG establish a reasonable framework under which it could raise additional equity and decrease reliance on outside financing.

GMG Request

GMG requested that the Commission:

> Approve its 2015 proposed capital structure and grant permission to issue securities in accordance with the limits identified in the Department's Comments and the equity ratio calculation method proposed in the original Petition.
>
> Direct that GMG's subsequent capital structure filing propose a five-year capital structure plan and re-evaluate the equity and debt ratios.

STAFF COMMENT

Staff generally agrees with the analysis and recommendations of the Department. Staff thinks it is unnecessary for the Commission to direct GMG to propose, in future securities issuance filing, a five-year capital structure plan and to re-evaluate the Company's equity and debt ratios. The

Company is free to include a five-year structure in its securities issuance petitions if it so desires. However, at this time, the implications of such a proposal have not been explored and there is no defined purpose or goal in statute or rule for such a filing.

If the GMG believes that having a dividend plan would help it to acquire additional equity, it is free to propose such a plan. However, given GMG's current equity and debt ratios and growth plans, and absent a detailed strategy for obtaining additional equity to reduce its financial leverage, staff thinks it would be premature for GMG to discuss a dividend plan.

Regarding an inclusion of its debt and equity ratios in its filing, regardless of the Company's evaluation, the Department has been providing such an evaluation it its comments and the Commission has been able to make decisions based on that analysis. The Department comments demonstrate that GMG's current and proposed equity ratios are lower than the average equity ratio of 2013 year-end values of 48 percent for publicly traded gas utilities with bond ratings from BBB- to A-.

Commission Options

Some Commission options are:

A. Approval of the Petition

   1. Approve the Petition as filed.

   2. Approve GMG's 2015 proposed capital structure and grant permission to issue securities in accordance with the limits identified in the Department's Comments and the equity ratio calculation method proposed in GMG's original Petition. (This would essentially be B. below with the exception of B. 1.)

B. Adopt the Department's recommendation and:

   1. Approve the Department's alternative proposed 2015 capital structure, as shown in Table 6 of the Department comments;

   2. Require GMG to file a new securities issuance and capital structure petition by January 1, 2016;

   3. Approve an equity ratio contingency range of 31.59 percent to 38.61 percent;

   4. Require that GMG maintain an equity ratio contingency range of at least 31.59 percent at all times;

   5. Require GMG make monthly compliance filings on or before the 15th of each month containing a balance sheet, income statement, and cash flow statement for the first of the prior two months, demonstrating that its equity ratio is at least 31.59 percent, and require the Company to include amounts drawn on its line of credit in its short-term debt total;

6. Approve a short-term debt contingency cap of 10 percent (i.e., GMG's short-term debt is not to exceed 10 percent of its total capitalization, including the contingency, for more than 60 days);

7. Approve a total capitalization contingency of $3.4 million above the estimated 2015 year-end total capitalization of $33.7 million, for a total capitalization of $37.1 million; and

8. Direct GMG to provide the following information within 20 days of each nonrecurring issuance of securities, including conventional bank financing:

   a. The specific purposes for individual issuances;
   b. The type of issuances;
   c. The timing of issuances;
   d. The amount of issuances;
   e. Issuance costs; and
   f. Interest rates.

C. Direct that GMG's subsequent capital structure filing propose a five-year capital structure and re-evaluate GMG's equity and debt ratios.