

Staff Briefing Papers Volume III: Cost of Capital

Meeting Date **October 9, 2025**

Agenda Item **2*****

Company Greater Minnesota Gas, Inc.

Docket No. G-022/GR-24-350

In the Matter of the Application of Greater Minnesota Gas, Inc. for Authority to Increase Rates for Natural Gas Utility Service in Minnesota

- Issues
1. What is the Appropriate Capital Structure?
 2. What is the Appropriate Cost of Debt?
 3. What is the Appropriate Cost of Equity?
 4. What is the Appropriate Rate of Return?

Staff Jason Bonnett jason.bonnett@state.mn.us 651-201-2235



Relevant Documents

Date

Relevant documents are listed on the cover page of Vol. I of the briefing papers.

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The attached materials are work papers 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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I. Introduction

The Commission needs to determine the appropriate overall rate of return, which is then applied to the rate base – the investment needed to provide service – to help determine the revenue requirement.

The overall rate of return reflects the relative proportions of capital securities (i.e., financing) comprising the capitalization of Greater Minnesota Gas (GMG or the Company), and their respective costs.

Generally, the cost rates of long- and short-term debt may be directly observed and are not always a matter of controversy. In this case, cost of debt is not disputed.

Additionally, the parties in this case agreed on the capital structure ratios.¹ The results of these agreements are shown below:

Table 301: Agreed Upon Capital Structure and Cost of Debt

Type of Capital	Capital Ratio (%)	Cost (%)	Weighted Cost Rates (%)
Long-Term Debt	50.44%	5.76%	2.91%
Short-Term Debt	0.68%	8.00%	0.05%
Common Equity	48.87%	X%	48.87% x X%
Total	100.00%		2.91% + 0.05% + (48.87% x X%)

As can be seen, once the cost of equity (x) is determined, its weighted cost may be calculated. When that is done, the weighted costs are summed to find the total cost, or overall rate of return. The cost of common equity is the single disputed item among the parties.

II. Background

In its Petition, GMG proposed continuation of its Commission approved return on equity (ROE) of 10 percent² with an additional 33 basis points for flotation costs, for a total ROE of 10.33

¹ Ex. JOINT-001 Resolved Issues List.

² Ex. GMG-103 at 3 (Palmer Direct).

percent.³ In rebuttal testimony, GMG revised its proposed flotation costs downward to 15 basis points, for a total ROE of 10.15 percent.⁴

The Minnesota Department of Commerce, Division of Energy Resources (Department) recommended an ROE of 9.65 percent based on market data from the date of GMG's initial filing with no flotation cost adjustment. The Department maintained their recommendation in surrebuttal testimony.

The Administrative Law Judge (ALJ) recommended a 10.00 percent return on common equity with an additional 15 basis points for flotation costs, for a total ROE of 10.15 percent.⁵

The positions of the parties and the ALJ recommendation on the cost of common equity and resultant overall rate of return (ROR) are shown below.

Table 302: Cost of Equity Proposals

Party	Cost of Common Equity (x)	Weighted Cost	Overall ROR
GMG	10.15%	4.96%	7.92%
DOC	9.65%	4.72%	7.68%
ALJ	10.15%	4.96%	7.92%

For comparison, staff notes that in GMG's last rate case, in Docket No. 09-962, the Commission authorized the following capital structure, cost rates, and weighted average cost of capital.⁶

Table 303: GMG 2009 Rate Case Cost of Capital

Type of Capital	Capital Ratio (%)	Cost (%)	Weighted Cost (%)
Long-Term Debt	59.93%	6.45%	3.87%
Common Equity	40.07%	10.00%	4.01%
Total (Overall ROR)	100.00%		7.87%

³ Ex. GMG-103 at 13 (Palmer Direct).

⁴ Ex. GMG-112 at 10, 16 (Palmer Rebuttal).

⁵ ALJ Report ¶¶ 156 and 167.

⁶ *In the Matter of the Application of Greater Minnesota Gas, Inc., for Authority to Increase Rates for Natural Gas Service in the State of Minnesota*, Docket No. G-022/GR-09-962, FINDINGS OF FACT, CONCLUSIONS, AND ORDER at 7, (August 19, 2010).

III. Legal Standard

The general criteria informing fair rate of return decisions were established in a landmark case, *Bluefield Water Works & Improvement Company v. Public Service Commission of West Virginia* (Bluefield). In that case, the United States Supreme Court ruled that:

The return should be reasonably sufficient to assure confidence in the financial soundness of the utility, and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may be reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market, and business conditions generally.⁷

In *Federal Power Commission v. Hope Natural Gas Company* (Hope), the Supreme Court further elaborated on the standard of reasonable return on equity:

From the investor or company point of view, it is important that there be enough revenue not only for operating expenses, but also for the capital costs of the business. These include service on the debt and dividends on the stock. . . . By that standard, the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and attract capital.⁸

The standard established by the Supreme Court resolves into the following three requirements:

The allowed rate of return should

- a. Be commensurate with returns on enterprises with corresponding risks;
- b. Sufficient to maintain the financial integrity of the regulated company; and
- c. Adequate to allow the company to attract capital on reasonable terms.

The cost of equity witnesses recommended that the Commission authorize a rate of return on common equity that satisfies the requirements from the Bluefield and Hope cases.

The Minnesota Supreme Court has adopted and applied the Bluefield and Hope framework, including Bluefield's decision that:

Rates which are not sufficient to yield a reasonable return on the value of the property used, at the time it is being used to render the service, are unjust,

⁷ *Bluefield Water Works & Improvement Company v. Public Service Commission of West Virginia*, 262 U.S. 679, 693 (1923).

⁸ *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591, 603 (1944).

unreasonable, and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment.⁹

The Minnesota Supreme Court in *Hibbing Taconite Co. v. Minnesota Department of Public Service Commission* (Hibbing), further instructed that to avoid the imposition of confiscatory rates, the Commission must consider all relevant facts and circumstances and provide a return that:

- (1) is comparable to returns on investments in businesses with similar risks;
- (2) is sufficient to assure confidence in the utility's financial integrity, so that it can maintain its credit and attract capital; and,
- (3) reflects a balancing of the interests of the utility and its customers.¹⁰

Additionally, Minnesota Statutes provide guidance on the issue. In determining just and reasonable rates, the Commission is required to:

Give due consideration to the public need for adequate, efficient, and reasonable service and to the need of the public utility for revenue sufficient to enable it to meet the cost of furnishing service, including adequate provision for depreciation of its utility property used and useful in rendering service to the public, and to earn a fair and reasonable return upon the investment in such property.¹¹

IV. Capital Structure

A. Introduction

All other things being equal, more equity in a capital structure makes investing a safer decision for an outside investor. A greater proportion of equity reduces the possibility that there will not be enough earnings to pay interest on the (reduced amount) of debt and, additionally, it increases the probability that sufficient earnings remain to pay dividends on the equity. Where the proportion of debt is small, lenders will also have reduced concerns about recovering their investment in the event of bankruptcy.

Since it is the highest cost form of capital, equity in too great a proportion increases costs to ratepayers, who both pay for too much high-cost equity and too little low-cost debt, and it reduces shareholders' chances to leverage a higher return out of their investment. It is necessary, therefore, to strike an appropriate balance with enough equity for safety but not so much that costs are unnecessarily high.

⁹ *Hibbing Taconite Co. v. Minnesota Public Service Commission*, 302 N.W.2d 5, 10 (Minn. 1980) (citing *Bluefield*, 262 U.S. at 690).

¹⁰ *Id.*

¹¹ Minn. Stat. § 216B.16, subd. 6.

B. Case Record

ALJ Report at ¶¶ 75-78, 123-125
Ex. JOINT-001 Resolved Issues List
Ex. GMG-103 at 3-11 (Palmer Direct)
Ex. GMG-112 at 14-18 (Palmer Rebuttal)
Ex. DOC-201 at 18-22, 73-74 (Addonizio Direct)
Ex. DOC-203 at 3-5, 14 (Addonizio Surrebuttal)

C. Party Positions

1. GMG

GMG proposed a capital structure composed of 51.08 percent common equity, 48.23 percent long-term debt, and 0.68 percent short-term debt.¹² GMG noted that approximately \$2.1 million of its debt is a loan from the Small Business Administration (SBA) that requires personal guarantees from certain GMG shareholders.¹³ GMG treated the debt as equity, given that it is proved through shareholder guarantees.¹⁴

2. Department

The Department agreed that the personal guarantees for the SBA debt increased risk for certain shareholders but disagreed with GMG's allocation of the SBA loan as equity.¹⁵ Ultimately, the Department proposed to reclassify half of the SBA loan as equity.¹⁶

3. Evidentiary Hearing

During the evidentiary hearing, GMG accepted the Department's updated capital structure proposal.¹⁷ The agreement was memorialized by the Parties in a Joint Exhibit that was filed shortly after the evidentiary hearing.¹⁸

D. ALJ Report

The ALJ noted the following in her findings:

¹² Ex. GMG-103 at 3 (Palmer Direct).

¹³ *Id.* at 10.

¹⁴ *Id.*

¹⁵ Ex. DOC-201 at 19 (Addonizio Direct).

¹⁶ Ex. DOC-203 at 5 (Addonizio Surrebuttal).

¹⁷ Tr. Vol. 1 at 35 (Palmer).

¹⁸ Ex. JOINT-001 Resolved Issues List.

78. The parties' agreement is reasonable. The Administrative Law Judge recommends approving the classification of half of the SBA loans as equity and half as debt.

125. As provided in Joint Exhibit 1, the parties no longer disagree as to the component shares of GMG's capital structure or the costs of long-term or short-term debt. Thus, the only remaining cost of capital issue in dispute relates to an appropriate return on equity (ROE) to be used in setting rates for GMG.

E. Exceptions and Clarifications

No exceptions were filed on this issue.

F. Staff Analysis

The resolution reached by the Parties appears to be reasonable.

G. Decision Options for Capital Structure

301. Adopt the Company's proposed capital structure comprised of 50.44 percent long-term debt, 0.68 percent short-term debt, and 48.87 percent common equity. [GMG, Department, ALJ]

V. Cost of Debt

A. Introduction

The cost of debt consists of two components: short-term and long-term debt. Typically, short-term debt refers to any financial obligation that is due in less than one year, whereas long-term debt are financial obligations for greater than one year.

B. Case Record

ALJ Report ¶¶ 79-85

Ex. JOINT-001 Resolved Issues List

Ex. GMG-103 at 12 (Palmer Direct)

Ex. GMG-104, Schedule D-1 (Initial Filing – Volume 3)

Ex. GMG-112 at 16-18 (Palmer Rebuttal)

Ex. DOC-201 at 21-22 (Addonizio Direct)

Ex. DOC-203 at 2-5 (Addonizio Surrebuttal)

C. Party Positions

1. GMG

GMG initially proposed a test year cost of long-term debt of 5.61 percent¹⁹ and short-term cost of debt of 8.00 percent²⁰ based on the 13-month average over the period of December 1, 2024, through December 31, 2025.

In Rebuttal Testimony, GMG agreed to the Department's recalculation of cost of long-term debt. The updated cost of long-term debt is 5.76 percent.²¹

2. Department

The Department stated that in utility rate cases, the cost of debt includes not only interest expense, but also other one-time costs incurred when a utility issues debt, such as placement costs, fees, appraisal costs, etc., which are amortized over the life of the debt issuance. GMG included an estimate of its annual debt-related amortization expense of \$36,000 in its total interest expense calculation, but did not include that expense in its calculation of its long-term cost of debt of 5.61 percent.²² The Department recalculated GMG's cost of long-term debt with its debt amortization expense included and derived a revised estimate of 5.76 percent.²³ The Department recommended that the Commission approve the revised cost of long-term debt.²⁴

D. ALJ Report

The ALJ noted the following in her findings:

85. The parties' agreement is reasonable. The Administrative Law Judge recommends approving a cost of short-term debt of 8.00 percent.

E. Exceptions and Clarifications

No exceptions were filed on this issue.

F. Staff Analysis

The resolution reached by the Parties appears to be reasonable.

¹⁹ Ex. GMG-103 at 12 (Palmer Direct); Ex. GMG-105, Schedule D-1 (Initial Filing – Volume 3).

²⁰ *Id.*

²¹ Ex. GMG-112 at 10 (Palmer Rebuttal).

²² Ex. DOC-201 at 21 (Addonizio Direct).

²³ *Id.* at 22.

²⁴ *Id.* at 76.

G. Decision Options for Cost of Debt

Long-Term Debt

302. Adopt the proposed cost of long-term debt of 5.76 percent. [GMG, Department, ALJ]

Short-Term Debt

303. Adopt the proposed cost of short-term debt of 8.00 percent. [GMG, Department, ALJ]

VI. Cost of Equity

A. Introduction

There are many factors in determining a fair and reasonable return, one of the most critical is the return on common equity, which—together with debt—finances utility infrastructure. The Commission must set rates at a level that permits investors an opportunity to earn a fair and reasonable return on their investment and also permits the utility to continue to attract investment.

There are several analytical methods that can be used to calculate a reasonable cost of equity. The methods used by the parties are discussed below.

Discounted Cash Flow Model

Discounted Cash Flow (DCF) modeling relies on the concept that a reasonable return on equity can be reached by examining stock prices and market projections of expected growth for a proxy group of companies assumed to be similar to GMG. Selection of an appropriate ‘proxy group’ is critical, because different types of companies have different long-term growth prospects, dividend yields, and risk profiles, resulting in very different required capital returns. As an extreme example, an online company in a competitive market will have very different growth prospects and risk profiles from a gas utility and so would be a poor proxy for a company such as GMG.

The DCF model has three components: current stock price, future dividend payments, and the required rate of return on equity. With estimates of any two of the inputs, the third can be calculated. If annual dividends grow at a constant rate over an infinite period, the required rate of return on common equity capital can be estimated with the following formula:

$$k = D1/P + g$$

Where k is Return on Equity, $D1$ is the dividend in year one, P is the average stock price, and g is the forecast earnings growth rate.

The forms of DCF modeling used in this case are the constant growth DCF (CGDCF), the two-stage growth DCF (TGDCF), and a three-stage growth DCF (Multi-Stage DCF). Each use the same basic data, but the constant growth DCF assumes that projected growth in both the short and

long term are the same, while the two-stage DCF assumes that short-term growth and long-term growth can be different, while the Multi-Stage DCF assumes a transition period between short- and long-term growth. The basic approach is to continue the analysis of the constant growth model for five years, but to revise the growth in later years of the model towards the overall mean for companies with growth rates significantly different from the overall mean growth.

The DCF model has been widely used in regulatory proceedings for decades and has been consistently relied on by the Commission in previous rate cases.

Capital Asset Pricing Model

The Capital Asset Pricing Model (CAPM) defines risk as the relationship of a security's returns with the market's returns. This relationship is measured by beta (β), an index measure of an individual security's volatility relative to the market. A beta less than 1.0 indicates lower volatility than the market and a beta greater than 1.0 indicates greater volatility than the market. The CAPM assumes that all non-market, or unsystematic, risk can be eliminated through diversification and that investors require compensation for risks that cannot be eliminated through diversification.

The model is applied by adding a risk-free rate of return to a market risk premium. The market risk premium is adjusted proportionally to reflect the systematic risk of the individual security relative to the market as measured by beta.

In its simplest form, the CAPM assumes the following:

$$k = rf + \text{beta} (k_m - rf)$$

Where k is the required rate of return on the stock in question, rf is the rate of return on a riskless asset, and k_m is the required rate of return on a market portfolio consisting of all investable assets. The term in parentheses, which is the difference between the required market return and the risk-free rate, is referred to as the market risk premium, and represents the additional return, over and above the risk-free rate, investors require to hold a portfolio including all available investable assets.

The Department used the CAPM only as a check on reasonableness on its DCF analyses.

B. Case Record

ALJ Report ¶¶ 145-152, 155, 156
Ex. GMG-103 at 3, 7-8 (Palmer Direct)
Ex. GMG-112 at 9-18 (Palmer Rebuttal)
GMG Initial Brief at 18-26
GMG Reply Brief at 8-10
Ex. DOC-201 at 23-65, 66-73 (Addonizio Direct)
Ex. DOC-203 at 9-14 (Addonizio Surrebuttal)

Department Initial Brief at 6-16
 Department Reply Brief at 2-5
 Department Exceptions to ALJ Report at 10-14

C. Party Positions

1. GMG Direct

GMG proposed to continue its Commission-approved 10.00 percent ROE from its 2009 rate case. Specifically, GMG stated:

In an effort to minimize the issues in dispute in this proceeding, the Company does not propose any change to its currently authorized return on equity. The Company proposes using the same 10% return on equity approved by the Commission in its last rate case. . .²⁵

2. Department Direct

The Department recommended an ROE of 9.65 percent, including a risk adjustment.²⁶ In developing its ROE recommendation, the Department proposed use of the Multi-Stage DCF, with CAPM used as a check on reasonableness.²⁷ Table 304 summarizes the results.

Table 304: Summary of Multi-Stage DCF Results

Model	Mean Low ROE	Mean Avg. ROE	Mean High ROE
Multi-Stage DCF with 10-year 2nd stage	7.93%	8.52%	9.71%
Multi-Stage DCF with 20-year 2nd stage	8.23%	8.83%	9.92%

The Multi-Stage DCF analysis uses three distinct stages of growth. During the first stage, years one through five, assume dividends grow at forecasted 3-5-year earnings growth rates developed by equity analysts that study and publish research reports about publicly traded stocks. The second stage assumes each proxy company's dividend growth rate converges linearly from the stage one growth rate to the stage three growth rate. The third stage assumes dividends for all the Department's Proxy Group companies grow at the same rate as U.S. Gross Domestic Product (GDP).²⁸ The Department used two different lengths for the second stage transition period: 10 years and 20 years.

²⁵ Ex. GMG-103 at 3 (Palmer Direct).

²⁶ Risk adjustment is discussed below in Section VI.E.

²⁷ Ex. DOC-201 at 40 (Addonizio Direct).

²⁸ GDP is defined as the measurement of the monetary value of all finished goods and services produced within the United States during a specified period.

For the first five years of its DCF analyses, the Department used projected earnings growth rates provided by two widely used and respected investor services, S&P Capital IQ Pro and Zacks Investment Research (Zacks). For the second stage, the Department used two different transition periods, ten years and twenty years. The third stage uses the growth rates put forth by the Energy Information Administration (EIA) and the U.S. Social Security Administration (SSA). Both publish long-term average, high, and low-growth GDP forecasts, and the Congressional Budget Office publishes a long-term average GDP growth forecast. The Department used the mean of the three average forecasts as its mean, long-term GDP growth forecast, and the mean of the EIA and SSA high and low forecasts for sensitivity analyses. Table 305 summarizes the GDP growth rates and compares them to the mean, high, and low average earnings growth rates used in the first stage of the Department’s multi-stage DCF analyses.

Table 305: Summary Growth Rates²⁹

	Low	Mean	High
<u>Long-Term GDP Growth Rates</u>			
Energy Information Administration	4.38%	4.45%	5.42%
Social Security Administration	2.45%	3.94%	5.33%
Congressional Budget Office		3.53%	
Average	3.41%	3.98%	5.38%
<u>Equity Analyst 5-Year Earnings Growth Rates</u>			
Average	5.90%	6.54%	7.19%
Difference	-2.49%	-2.57%	-1.81%

Table 305 shows that the average equity analyst earnings growth forecasts are 1.8 to 2.6 percentage points higher than the long-term GDP forecasts and are, according to the Department, not realistic as perpetual growth rates.

Finally, the Department included the results from the constant growth and Two-growth DCF analyses. Table 306 shows the results.

Table 306: Constant-Growth and Two-Growth DCF Models³⁰

Model	Mean Low ROE	Mean Avg. ROE	Mean High ROE
Constant Growth DCF	9.73%	10.38%	11.03%
Two-Growth DCF	9.93%	10.50%	10.90%

The Department concluded that average authorized ROEs over the period 2009-2011, when GMG last filed a rate case, were generally in the range of 10.0-10.5 percent. Since then, average authorized ROEs have declined and, over the past year, have been in the range of 9.5-10.0

²⁹ Ex. DOC-201 at 35, Table 4 (Addonizio Direct).

³⁰ Ex. DOC-201 at 37, Table 6 (Addonizio Direct).

percent. Therefore, to the extent GMG's requested 10.0 percent authorized ROE was reasonable in 2009, a slightly lower ROE may be reasonable now. Specifically, the Department stated:

Consistent with the market-to-book ratios presented earlier, authorized returns over the past year appear to have been greater than the cost of equity, which has been somewhat volatile. Recognizing that I cannot fully explain this gap, I would not recommend setting any utility's ROE equal to my cost of equity estimate, despite the theoretical reasons to do so, as that would be a large, abrupt change to an ROE that would be notably lower than any other approved ROE and may have unintended consequences. Instead, I would recommend setting an authorized ROE that closes the gap somewhat between current authorized ROEs and the cost of equity. For a larger, publicly traded utility, I might recommend an authorized ROE towards the bottom the range of recently authorized ROEs, such as 9.2 or 9.3 percent.³¹

Ultimately, the Department recommended the Commission approve an authorized ROE of 9.65 percent stating:

My recommendation is 35 basis points lower than the Company's requested ROE of 10.0 percent, but is reasonably 40 basis points higher than my recent recommendation for CenterPoint Energy Minnesota Gas, reflecting GMG's higher risk.

Further, in GMG's last rate case in 2009, it effectively requested and received an authorized ROE of 4.24 percent. Despite that low authorized ROE, GMG was able attract enough capital to triple its rate base between 2010 and 2017 (from \$12.1 million to \$36.4 million). My recommended ROE should therefore pose no issues with respect to the Company's ability to attract capital.³²

3. GMG Rebuttal

In response, GMG disagreed with the Department's recommendation to use the Multi-Stage DCF analysis, noting that the Department's proposed ROE doesn't accurately reflect the unique risk factors facing GMG.

GMG recommended that the Commission instead look to the results of the Two-Stage Growth DCF analysis, which the Commission has used to determine a reasonable cost of equity in the other recent rate cases. GMG argued that the Company's requested 10.00 percent ROE is not only appropriate, but a conservative estimate of GMG's cost of equity.

³¹ Ex. DOC-201 at 63 (Addonizio Direct).

³² *Id.* at 63.

4. Department Surrebuttal

The Department updated its cost of equity analyses to account for the passage of time since previous testimony. Table 307 shows the updated Multi-Stage DCF analyses.

Table 307: Summary of Updated Multi-Stage DCF Results³³

Model	Mean Low ROE	Mean Avg. ROE	Mean High ROE
Multi-Stage DCF with 10-year 2nd stage	7.78%	8.35%	9.54%
Multi-Stage DCF with 20-year 2nd stage	8.12%	8.69%	9.77%

The Department's updated multi-stage DCF model results are roughly 10-20 basis points lower than the results presented in direct testimony. The Department noted between February 5, 2025 (the date of its analyses in direct testimony) and March 28, 2025, the stock prices of the gas utilities in the DOC Proxy Group increased, which, the Department noted with all else equal, drives down the cost of equity. A small portion of this decrease was offset by an increase in the average 3–5 year equity analyst earnings growth estimate the Department used to calculate dividends for the first five years of the analyses. However, the long-term GDP growth estimates used in the multi-stage DCF analyses, which have a larger effect on the results, remained essentially unchanged.

The Department also updated its constant- and two-growth DCF analyses.

Table 308: Summary of Updated Constant-Growth and Two-Growth DCF Models³⁴

Model	Mean Low ROE	Mean Avg. ROE	Mean High ROE
Constant Growth DCF	9.84%	10.44%	11.04%
Two-Growth DCF	10.09%	10.68%	11.12%

The Department observed the results were 1-18 basis points higher than the results presented in direct testimony, as effects of the increase in 3–5 year earnings growth estimates outweighed the effects of the decrease in dividend yields.

The Department summarized its approach to determining its proposed ROE by noting that there are strong theoretical reasons to set a utility's authorized ROE equal to its cost of equity. The Department noted that the cost of equity for an average gas utility is likely around 8.35 percent, based on its mean 10-year multi-stage DCF analysis. However, empirical data (historical market-to-book ratios) suggest that authorized ROEs are typically set above the cost

³³ Ex. DOC-203 at 9, Table 1 (Addonizio Surrebuttal).

³⁴ Ex. DOC-203 at 10, Table 2 (Addonizio Surrebuttal).

of equity. The relationship between the Department's cost of equity estimate produced in both direct and surrebuttal testimonies and recent authorized ROEs is consistent with this idea.

For a larger gas utility, based on updated modeling results, the Department stated it would likely recommend an authorized ROE between 9.0 and 9.2 percent, notably higher than the cost of equity, but lower than average authorized ROEs in other jurisdictions. In sum, the Department continued to recommend the Commission approve an authorized ROE of 9.65 percent.

In response to GMG's discussion regarding the Commission's authorized ROE in the Xcel Energy natural gas rate case, the Department noted that the authorized ROE was agreed to in a settlement and therefore resulted as much from negotiation as from modeling and analysis. In addition, the Department pointed out that in direct testimony in the Xcel Energy case, it recommended an authorized ROE of 9.40 percent with its mean 10-year multi-stage DCF estimate being 9.01 percent, compared to 8.52 percent in its direct testimony in this case. Thus, the Department noted that despite the model result on which it placed the most weight being 49 basis points lower than in the Xcel Energy case, the recommended authorized ROE in direct testimony was 25 basis points higher than in the Xcel Energy case.³⁵

5. ALJ Report

The ALJ observed that the Commission has traditionally relied on the Two-Growth DCF model noting that the Commission has specifically rejected prior proposals by the Department to base ROE determinations on a multi-stage DCF analysis. The ALJ found that GMG's proposed ROE was reasonable and within the range set forth in the Department's Two-Growth DCF analysis.

The ALJ noted the following in her findings:

145. The Commission has long relied on the results of DCF modeling on a "proxy group" of publicly traded utilities, specifically the two-growth DCF model, to determine a utility's cost of equity. In 2020, the Commission formally determined:

The Commission finds that the transparency and objectivity of the DCF model make it the strongest, most credible model, and that the most reasonable way to proceed is to use its results as a baseline and to use the results of other models to check, inform, and refine those results.

146. The Commission relied on this conclusion in other recent ratemaking matters. In the most recent Xcel Energy electric rate case, for example, the Commission stated:

The Commission concurs with the Administrative Law Judge that there is no convincing basis on this record for departing from reliance on the two-growth DCF model. The two-growth DCF model provides a fundamentally sound framework through which to

³⁵ Ex. DOC-203 at 8 (Addonizio Surrebuttal).

analyze the Company's relative risk in relation to comparable companies, and through which to evaluate the Company's financial integrity and ability to attract investors in light of current as well as expected market conditions.

147. In addition, the Commission has specifically considered and expressly rejected prior proposals by the Department to base ROE determinations on a multi-stage DCF analysis. As the Commission explained:

The Department's recommended cost of equity of 9.30% is informed by an underlying assumption that the cost of equity and the return on equity are distinct concepts in the sense that utility earnings exceed the cost of equity over time. This understanding, according to the Department, undermines the reliability of earnings estimates in predicting long-term growth and instead justifies the use of a multi-stage DCF analysis that uses GDP to forecast the long-term cost of equity.

The Commission does not share this concern. While general statements about GDP and earnings estimates may offer broad perspectives on their overall usefulness, the parties' positions reflect philosophical and methodological differences that are qualitative in nature. But the Department has not demonstrated inaccuracies in Minnesota Power's earnings estimates in this case to justify dismissing them from consideration. The investment community relies heavily on earnings estimates, which are rigorously audited to ensure compliance with accounting principles. And in the case of utilities, earnings estimates reflect industry-specific considerations, include assumptions based upon quantitative market data, and have not been shown to produce unreasonable returns.

148. The Commission has never based an ROE determination upon the results of a multi-stage DCF analysis.

149. The record contains the results of two separate two-growth DCF analyses, both of which Addonizio completed. In his Direct Testimony, Addonizio's two-growth DCF analysis indicated a "mean average" ROE for his six company "proxy group" of 10.50 percent and a "mean high" ROE for that proxy group of 10.90 percent.

150. In Rebuttal Testimony, GMG's witness Palmer agreed with the results of the Department's two-growth DCF analysis. Palmer found the results "reasonable for estimating the cost of capital for large publicly traded utilities and these calculations can inform the determination of an appropriate ROE for GMG."

151. By the time of Addonizio’s Surrebuttal Testimony, and using updated market data, the two-growth DCF “mean average” and “mean high” ROEs rose slightly, to 10.68 and 11.12 percent, respectively.

152. Before considering any of GMG’s unique risks as compared to the proxy companies, and employing the analysis long relied on by the Commission, the most conservative ROE estimate for GMG is 10.50 percent – 50 basis points above GMG’s base ROE request.

155. Even without quantifying the impact of these higher risks with precision, the record supports GMG’s requested ROE because it is well below the ROE indicated by the two-stage DCF analyses.

156. The hearing record demonstrates that 10.00 percent is a conservative return on equity that balances Company and customer interests.

6. Exceptions

The Department argued that its recommendation was developed after extensive financial modeling and the range of returns suggested by GMG, and accepted in the ALJ Report, are completely out of line with both the Commission’s decisions and the ROEs awarded to other companies in the Department’s proxy group. The Department noted that the 10.68 percent and 11.12 percent “mean average” and “mean high” ROEs produced by the two-growth DCF model at the time of surrebuttal, which GMG and the ALJ Report claim are reasonable, exceed anything authorized by the Commission in the past 15 years.

While the ALJ Report frames the Commission’s decisions as a rejection of the Department’s multi-stage DCF model, the Department argued that the Commission orders cited in this proceeding reflect the Commission’s practice of considering data from multiple sources and considering the record as a whole when setting ROE. The Department noted that in Xcel Energy’s 2021 electric rate case, the authorized ROE selected by the Commission matched the Department’s recommendation, which relied most heavily on the results of a multi-stage DCF model.³⁶

The Department concluded that although GMG and the ALJ Report argued that GMG will be unable to attract necessary capital if it does not receive its requested ROE, there is nothing in the record that contradicted the evidence offered by the Department that GMG was able to raise sufficient capital at a much lower effective ROE.³⁷

The Department recommended the following adjustments be made to the ALJ Report.

³⁶ Department exceptions at 14.

³⁷ *Id.*

145. The Commission has long relied on the results of DCF modeling on a “proxy group” of publicly traded utilities, ~~specifically the two growth DCF model~~, to determine a utility’s cost of equity. In 2020, the Commission formally determined:

The Commission finds that the transparency and objectivity of the DCF model make it the strongest, most credible model, and that the most reasonable way to proceed is to use its results as a baseline and to use the results of other models to check, inform, and refine those results.

~~146. The Commission relied on this conclusion in other recent ratemaking matters. In the most recent Xcel Energy electric rate case, for example, the Commission stated:~~

~~The Commission concurs with the Administrative Law Judge that there is no convincing basis on this record for departing from reliance on the two growth DCF model. The two growth DCF model provides a fundamentally sound framework through which to analyze the Company’s relative risk in relation to comparable companies, and through which to evaluate the Company’s financial integrity and ability to attract investors in light of current as well as expected market conditions.~~

~~147. In addition, the Commission has specifically considered and expressly rejected prior proposals by the Department to base ROE determinations on a multi stage DCF analysis. As the Commission explained:~~

~~The Department’s recommended cost of equity of 9.30% is informed by an underlying assumption that the cost of equity and the return on equity are distinct concepts in the sense that utility earnings exceed the cost of equity over time. This understanding, according to the Department, undermines the reliability of earnings estimates in predicting long term growth and instead justifies the use of a multi stage DCF analysis that uses GDP to forecast the long term cost of equity.~~

~~The Commission does not share this concern. While general statements about GDP and earnings estimates may offer broad perspectives on their overall usefulness, the parties’ positions reflect philosophical and methodological differences that are qualitative in nature. But the Department has not demonstrated inaccuracies in Minnesota Power’s earnings estimates in this case to justify dismissing them from consideration. The investment community relies heavily on earnings estimates, which are rigorously audited to ensure compliance with accounting principles. And in the case of utilities, earnings estimates reflect industry specific considerations, include assumptions based upon quantitative market data, and have not been shown to produce unreasonable returns.~~

~~148. The Commission has never based an ROE determination upon the results of a multi stage DCF analysis.~~

149. The record contains the results of two separate two-growth DCF analyses, both of which Addonizio completed. In his Direct Testimony, Addonizio’s two-

growth DCF analysis indicated a “mean average” ROE for his six company “proxy group” of 10.50 percent and a “mean high” ROE for that proxy group of 10.90 percent. Addonizio explained that he no longer relies on this model because equity analysts’ long-term earnings growth forecasts overestimate future growth and are unrealistic, supported by citations to research including popular corporate finance textbooks.

150. In Rebuttal Testimony, GMG’s witness Palmer agreed with the results of the Department’s two-growth DCF analysis. Palmer found the results “reasonable for estimating the cost of capital for large publicly traded utilities and these calculations can inform the determination of an appropriate ROE for GMG.” Palmer did not respond to Addonizio’s analysis explaining why equity analysts’ long-term earnings growth forecasts are unrealistic and produce unreasonable ROEs.

151. By the time of Addonizio’s Surrebuttal Testimony, and using updated market data, the ~~two-growth~~ multi-stage DCF with 10-year 2nd stage “mean average” and “mean high” ROEs rose ~~decreased~~ slightly, by around 10 to 20 basis points ~~to 10.68 and 11.12 percent, respectively.~~

152. Based on the results of its 10-year multi-stage DCF model and the additional adjustments made for risk factors unique to GMG, the Department recommended an ROE of 9.65%. In choosing this recommended ROE, the Department noted that this was 40 basis points higher than the Department’s recommendation in another recent gas rate case, reflecting GMG’s higher risk. The Department also considered that GMG had been able to triple its rate base between 2010 and 2017, despite having agreed to an effective ROE of 4.24% in its last rate case, leading the Department to conclude that an ROE of 9.65% would pose no issues with respect to GMG’s ability to attract capital. ~~Before considering any of GMG’s unique risks as compared to the proxy companies, and employing the analysis long relied on by the Commission, the most conservative ROE estimate for GMG is 10.50 percent — 50 basis points above GMG’s base ROE request.~~

~~155. Even without quantifying the impact of these higher risks with precision, the record supports GMG’s requested ROE because it is well below the ROE indicate by the two-stage DCF analyses.~~

156. The hearing record demonstrates that the Department’s recommended 9.65% ~~10.00 percent is a conservative~~ return on equity ~~that~~ balances Company and customer interests, and allows an adequate return on investor equity to support its credit and enable GMG to raise the money necessary for the proper discharge of its public duties.

7. Staff Analysis

The primary issue is what level of ROE the Commission determines is appropriate in this proceeding. Historically, the Commission has consistently favored the Two-Growth DCF model

over the Multi-Stage DCF model. As discussed above, the Commission specifically rejected using the Multi-Stage DCF model in both Xcel Energy's and Minnesota Power's most recent rate cases and instead chose to continue relying on the Two-Growth DCF model noting "the two-growth DCF model provides a fundamentally sound framework through which to analyze the Company's relative risk in relation to comparable companies, and through which to evaluate the Company's financial integrity and ability to attract investors in light of current as well as expected market conditions."³⁸ The Commission may wish to further explore this issue with the parties at its October 9th agenda meeting.

8. Decision Options

Analytical Models

304. Determine that no single model is appropriate for estimating the cost of equity.

Or

305. Determine that the constant-growth Discounted Cash Flow model, checked for reasonableness, is the most appropriate method for estimating the cost of equity.

Or

306. Determine that the two-growth Discounted Cash Flow model, checked for reasonableness, is the most appropriate method for estimating the cost of equity. [GMG, ALJ]

Or

307. Determine that the multi-stage Discounted Cash Flow model, checked for reasonableness, is the most appropriate method for estimating the cost of equity. [Department]

Return on Equity

308. Adopt GMG's proposed 10.00 percent return on equity for setting rates in this proceeding. [GMG, ALJ]

Or

309. Adopt the Department's proposed 9.65 percent return on equity for setting rate in this proceeding. [Department]

[If the Commission makes this determination, it may want to adopt one or more of the following recommended by the Department:]

³⁸ In the Matter of the Application of Northern States Power Company, dba Xcel Energy, for Authority to Increase Rates for Electric Service in the State of Minnesota, Docket No. E-002/GR-21-630, Findings of Fact, Conclusions and Order at 89 (July 17, 2023).

- a. Replace ALJ Findings 145, 149-152, and 156 with Department's proposed language.
- b. Reject ALJ Findings 146-148, 155.

Or

310. Determine that another return on equity is appropriate for setting rates in this proceeding.

D. Selection of Proxy Groups

1. Introduction

GMG is a wholly owned by Greater Minnesota Synergy, Inc. (GMS), which also owns Greater Minnesota Transmission, LLC., (GMT), which provides interstate natural gas transmission service to Minnesota; and Dakota Natural Gas, LLC, formed recently to provide natural gas distribution service in North Dakota.

The Commission must determine a reasonable cost of equity and factor that cost into rates. GMG's cost of common equity—essential to determining overall rate of return and the final revenue requirement—must therefore be inferred from market data for companies that present similar investment risks (referred to as a proxy group). Using a proxy group also moderates the effects of one-time events on a given company's stock.

Neither GMG nor GMS is publicly traded on a stock exchange. As a result, GMG's cost of equity cannot be analyzed directly. Therefore, the parties perform a DCF analysis on a group of companies whose investment risk is comparable to the investment risk of the Company. The benefit of using a proxy group is that the use of results for a group of companies moderates the effects of unusual events that may be associated with any one company. To estimate the cost of equity for GMG, the parties use DCF analyses for groups of companies with investment risks similar to that of the Company.

A properly constituted proxy group ensures that a DCF analysis is grounded in relevant comparable data.

2. Case Record

ALJ Report ¶¶ 133, 141, 145

Ex. DOC-201 at 16-18, 69-70, Attachments CMA-D-3, CMA-D-4, CMA-D-27 (Addonizio Direct).

Ex. DOC-203 at 9, 12, Attachment CMA-S-12

Ex. GMG-112 at 10-12 (Palmer Rebuttal)

Ex. GMG-103 at 7-8 (Palmer Direct)

3. Party Positions

a. GMG

GMG developed its proxy group using Value Line (an investment research service) as publicly traded natural gas utilities.

Table 309: GMG Proxy Group

Company	Ticker
Atmos Energy Corporation	ATO
NiSource Inc.	NI
UGI Corp.	UGI

b. Department

The Department developed a proxy group of companies from the following criteria:

- Categorized by Value Line as publicly traded natural gas utilities;
- Eliminated companies that received less than 60 percent of their operating income from regulated retail gas operations;
- Eliminated companies that are currently in the process of, or have recently completed, as significant corporate transaction such as a merger or acquisition; and
- Screened out companies that recently cut their dividends.

The Department noted that it is a well-accepted financial principle that companies with similar investment risks are expected to have similar costs of capital. The Department's proxy group consists of the following companies

Table 310: Department Proxy Group

Company	Ticker
Atmos Energy Corporation	ATO
NiSource Inc.	NI
Northwest Natural Holding Company	NWN
ONE Gas, Inc.	OGS
Spire Inc.	SR
Southwest Gas Holdings, Inc.	SWX

The Department noted that while the DOC Proxy Group companies are in the same line of business as GMG (regulated retail natural gas distribution), and therefore likely pose similar risks to investors as GMG, GMG is significantly smaller, and its stock is not publicly traded.

In response to GMG's proxy group, the Department noted that UGI Corporation, typically earns less than 20 percent of its annual operating income from regulated retail utility operations and is therefore not a reasonable proxy for GMG.³⁹

³⁹ Ex. DOC-201 at 70 (Addonizio Direct).

c. GMG Rebuttal

In response to the Department's testimony, GMG stated that although it did not believe the Department's proxy group properly reflected GMG's risk profile, it did find the DCF calculations derived from use of the Department's proxy group "reasonable for estimating the cost of capital for large publicly traded gas utilities and these calculations can inform the determination of an appropriate ROE for GMG."⁴⁰

4. ALJ Report

The ALJ noted the following in her findings:

133. GMG offered the testimony of its CEO, Palmer, a former President of Viking Gas Transmission and former Chief Financial Officer at Nuclear Management Company, in support of its position. In his Direct Testimony, Palmer:

(2) examined the ROEs of three large, publicly traded natural gas utilities (Atmos Energy, Nisource and UGI Corporation);

141. The "corresponding risks and uncertainties" faced by St. Croix Valley and Midwest Natural Gas are more like those of GMG than those faced by Minnesota's larger, urban natural gas utilities. Further, Department witness Craig Addonizio (Addonizio) selected a group of proxy companies for comparison to GMG, but acknowledged that GMG is much smaller than the selected proxy group, is too small for its stock to be traded on a major stock exchange, and has debt that is personally guaranteed by certain stockholders resulting in greater risk and a higher cost of equity.

5. Exceptions

Neither GMG nor the Department filed exceptions specifically on this issue.

6. Decision Options

311. Adopt GMG's proposed proxy group.

Or

312. Adopt the Department's proposed proxy group.

Or

313. Take no action on the recommendation of a proxy group.

⁴⁰ Ex. GMG-112 at 11 (Palmer Rebuttal).

E. Risk Factors Unique to GMG

1. Introduction

GMG stated that it is subject to unique risk factors that increase its cost of equity. These include its small size, customer concentration, market risk, and lack of current dividends. GMG argued that these risk factors should be considered with respect to their overall effect on the Company's risk profile.

2. Case Record

ALJ Report ¶¶ 134-144, 153, 154
 Ex. GMG-103 at 6-9 (Palmer Direct)
 Ex. GMG-112 at 12-14 (Palmer Rebuttal)
 GMG Initial Brief at 20-21
 GMG Reply Brief at 3-5
 Ex. DOC-201 at 49-51, 70-71 (Addonizio Direct)
 Ex. DOC-203 at 7-8 (Addonizio Surrebuttal)
 DOC Initial Brief at 10-12
 DOC Reply Brief at 7
 DOC ALJ Exceptions at 9-10

3. Party Positions

a. GMG

GMG noted it was established to provide access to rural Minnesota areas that did not previously have access to natural gas. GMG noted that the typical customer requesting service used propane or number 2 fuel oil for an energy source to heat their home or business. Those customers took service from GMG even though the rates were higher than that of the larger Minnesota utilities because service from the larger utilities was not an option. GMG argued its customers chose GMG to save 30 to 50 percent on their energy bills because they wanted to use safe, reliable natural gas which was not offered to them by any of the other utilities. The areas served by GMG require longer distribution facilities per customer served and service is to a different type of market.

GMG argued that it is significantly riskier than the proxy group companies used in the DCF analyses. GMG provided four examples of its riskier profile.

- Lack of Current Dividends – GMG argued it has never paid a dividend. All earnings of the Company have been reinvested in the company to meet capital requirements. The capital cost for the publicly traded companies is based on shareholders receiving dividends in the current year. Dividends for GMG are not currently being paid, thus there is a risk due to the time value of money and the ultimate payment of dividends is more uncertain due to the delay.

- Market Risk – GMG was created in 1995. The Company began serving rural Minnesota and continues to do so. The Company does not serve the major cities in Minnesota and its largest urban market is on the outer edges of Mankato. GMG’s markets consist primarily of residential customers and commercial customers tied to the food production industry. These markets tend to be less stable than large commercial, industrial, or governmental markets found in the larger cities.
- Small Size – In addition to the small markets served by GMG, the Company noted it is a fraction of the size of other utilities, including the other natural gas utilities serving in Minnesota. GMG argued that this small size further heightens the Company’s business risks, compared to the larger utilities in Minnesota.
- Equity Ratio – GMG argued its proposed equity ratio is below that allowed by the Commission for other utilities in the state. GMG noted the Commission has identified the Company’s lower equity ratios as posing risk in GMG’s annual capital structure dockets. GMG stated that it has consistently agreed to raise its equity ratio, and the Commission has relied on that commitment as part of its rationale for approving the Company’s capital structure requests.

GMG argued that consideration of the risk specific to GMG’s customer concentration is also necessary in determining its appropriate ROE. If a natural gas utility, like GMG, has a large percentage of volumes associated with a small group of customers, the utility’s exposure related to the default of any one customer is much greater than if the system had a broad base of customers that use similar levels of usage. GMG noted that approximately 30 percent of its sales was to the poultry industry, which is struggling with issues related to the avian bird flu. In addition, 6.5 percent of GMG’s estimated test year sales are to the agricultural grain drying business which is very volatile based on summer rain conditions. GMG noted that large gas utilities have the benefit of serving most of the large industrial natural gas loads within the state. GMG lacks that stable revenue base.

Finally, GMG cited two recent decisions by the Public Service Commission of Wisconsin (PSCW) awarding authorized ROE of 11 percent to two small natural gas utilities. Specifically, GMG stated:

The Wisconsin Public Service Commission recently approved an 11% return on equity with a 60% equity ratio for St. Croix Valley Natural Gas Company. Likewise, it approved an 11% Return on Equity with a 60% Equity Ratio for Midwest Natural Gas, Inc. The returns on equity allowed by the Wisconsin PSC recognize the inherently higher risk of investing in smaller companies; and, they represent determinations regarding appropriate returns on equity for investments that would generally be made at the same time and in the same part of the country, as per the Bluefield decision, particularly since each of those companies has service territory within 100 miles of GMG’s service area.⁴¹

⁴¹ Ex. GMG-103 at 9 (Palmer Direct).

b. Department

The Department noted that GMG's revenue in 2023 was less than 1.5 percent of any of the Department's proxy group companies. Also, GMG is too small for its stock to be traded on a major stock exchange, which makes it harder for GMG's equity owners to sell their holdings and harder for GMG to issue new equity. The Department agreed that both factors likely mean that GMG's cost of equity is higher than that of the Department's Proxy Group companies. However, the Department did not agree with the other risk factors cited by the Company.

With respect sales volatility, the Department argued that equity investors can mitigate their exposure to risks like weather by diversifying their investment holdings. The Department noted that weather is likely to "average out" across the holdings of a geographically diversified investor mitigating the risk associated with reduced sales by any one utility resulting from warm weather. For this reason, equity investors are generally thought to be compensated only for non-diversifiable risks, meaning risks that affect the industry or the economy as a whole but not for diversifiable risks like weather.

As for GMG's lack of current dividends, the Department argued that GMG has been reinvesting its earnings in its system rather than paying dividends which resulted in faster rate base growth than would have otherwise occurred. That faster rate base growth, in turn, has enhanced GMG's ability to pay dividends in the future. The Department noted that investors understand this dynamic and willingly accept lower cash flows in the present in exchange for larger cash flows in the future.

Finally, the Department argued that GMG's equity ratio is generally comparable to the Department's Proxy Group average, not meaningfully lower.⁴²

In response to the PSCW decisions cited by GMG, the Department agreed that those utilities likely had similar size and liquidity risks as GMG. However, the Department was unable to ascertain any analysis supporting the ROEs and what methodologies or factors were used in consideration of those estimates, the Department gave them little weight.

The Department noted the PSCW issued the orders in the spring of 2023, hot on the heels of the high inflation seen in 2022. The Department noted that the Commission's July 13, 2023, Order in Xcel's 2021 electric rate case, observed that "there was significant uncertainty about the direction, duration, and impact of inflation" while the parties were filing testimony through the fall of 2022 and into early 2023. As a result, it conducted on its own review of the trends in the inflation rate when making its decision. The Commission noted the substantial decline in inflation in 2023 before reaching its decision to adopt the Department's recommended 9.25 percent ROE. The Commission explained that it was not persuaded that it would be reasonable to set ROEs for years into the future based on data that "appear[ed] to be significantly impacted by a period of peak inflation."⁴³

⁴² Ex. DOC-201 at 70-71 (Addonizio Direct).

⁴³ *In the Matter of the Application of Northern States Power Company, dba Xcel Energy, for Authority to Increase Rates for Electric Service in the State of Minnesota*, Docket No. E-220/GR-21-630, FINDINGS OF

4. ALJ Report

The ALJ found GMG’s arguments persuasive and determined that GMG is significantly riskier than the proxy group companies used in these DCF analyses. The ALJ noted the following in her findings:

134. Palmer noted that, while there are few utilities “comparable” to GMG to look to for guidance on an appropriate ROE, two smaller utilities – St. Croix Valley Natural Gas Company (St. Croix Valley) and Midwest Natural Gas (Midwest Natural Gas) – operate “within 100 miles of GMG’s service area.”

135. St. Croix Valley serves approximately 8,700 customers in River Falls and Prescott, Wisconsin and nearby rural communities.

136. In a recent rate case, the Public Service Commission of Wisconsin (PSCW) approved a 60 percent equity ratio and an 11.00 percent ROE for St. Croix Valley, agreeing with PSCW Staff that an 11.00 percent ROE was “a reasonable level to balance the needs of customers and investors” and “remains reasonable in comparison to the returns authorized for [St. Croix Valley’s] peers.”

137. Midwest Natural Gas is slightly larger than either St. Croix Valley or GMG, serving approximately 14,500 customers. It also serves smaller communities in Western Wisconsin.

138. The PSCW also approved a 60 percent equity ratio and 11.00 percent ROE for Midwest Natural Gas, using identical language to that used regarding St. Croix Valley.

139. The ROE determinations in both St. Croix Valley and Midwest Natural Gas recognize that investing in smaller utilities can present higher risks than other comparable investment opportunities.

140. The experience of smaller gas utilities serving customers in rural midwestern communities, within 100 miles of the Company’s service area, is helpful and instructive. Though the PSCW may have different procedures and approaches than the Minnesota Commission, the recent ROE awards to St. Croix Valley and Midwest Natural Gas clearly are, in the phrasing of Bluefield, returns that are “generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties.”

141. The “corresponding risks and uncertainties” faced by St. Croix Valley and Midwest Natural Gas are more like those of GMG than those faced by Minnesota’s larger, urban natural gas utilities. Further, Department witness Craig Addonizio (Addonizio) selected a group of proxy companies for comparison to GMG, but

acknowledged that GMG is much smaller than the selected proxy group, is too small for its stock to be traded on a major stock exchange, and has debt that is personally guaranteed by certain stockholders resulting in greater risk and a higher cost of equity.

142. The Department addressed ROE through Addonizio's testimony recommending an ROE of 9.65 percent. In developing his recommendation, Addonizio placed primary reliance on his "multi-stage" discounted cash flow (DCF) analyses. In these calculations, he determined that a "cost of equity for an average risk gas utility is approximately 8.5 percent."

143. However, Addonizio also noted that "recent authorized ROEs have been significantly higher than that for reasons that I cannot fully explain, and setting a gas utility's authorized ROE at 8.5 percent would represent a risky, large, and abrupt change in standard ratemaking practice that may have unintended consequences."

144. Addonizio estimated that for a gas utility of average risk, a reasonable authorized ROE may be around 9.2 or 9.3 percent. After considering some of the special risks faced by GMG, he arrived at the recommended 9.65 percent ROE.

153. The hearing record shows that GMG is significantly riskier than the proxy group companies used in these DCF analyses, demonstrating the conservative nature of looking to "mean average" results from the proxy group to determine GMG's ROE. Specifically:

- (1) GMG is only between 0.3 percent and 1.34 percent the size of the proxy group companies meaning, among other things, less diverse revenue streams;
- (2) because GMG is not publicly traded, it is harder for shareholders to sell their stock if desired, and harder for GMG to issue new equity;
- (3) GMG has never paid a dividend, choosing instead to reinvest all earnings in the Company to meet its capital requirements; and
- (4) GMG's revenue streams are closely linked to demand from poultry and grain drying businesses, which adds significant volatility and risk to its business.

154. Each of these factors indicates that investments in GMG carry more risk than investments in the proxy companies, indicating a higher required ROE to compensate investors for that additional risk.

5. Exceptions

a. GMG

GMG did not file exceptions on this issue.

b. Department

The Department argued that the ALJ's Report's reliance on the PSCW's 2023 rate case decisions for *St. Croix Valley* and *Midwest Natural Gas*⁴⁴ was unreasonable and inappropriate. The Department made a three-pronged argument as to why the ALJ Report was erroneous. First, the Department noted that the Commission previously explained that it was not reasonable to set ROEs for years into the future based on data from 2022 and early 2023 because economic conditions at the time were "significantly impacted by a period of peak inflation."⁴⁵ The Department continued by stating "since the Commission was unwilling to set ROEs based on peak inflation in a rate case that was brought while that inflation was occurring, the Report's to anchor its analysis based on ROEs set while inflation was still running hot more than two years later is inexplicable."⁴⁶

Second, the Department pointed out that the Commission has determined that orders from other jurisdictions "have limited persuasive value because of the fact-intensive nature of cost of equity decision-making, ..." ⁴⁷ The PSCW did not include any information in its orders about which utilities it considered to be "peers" to St. Croix Valley or Midwest Natural, which financial models—if any—it used in its independent economic analysis, which conditions or factors it took into consideration, or what adjustments it made based on those judgments.

Finally, the Department did not dispute that GMG's small size makes it a riskier investment than a larger gas utility, as such, it made an upward adjustment to its recommended ROE to account for the added risk.⁴⁸ What is disputed, and what the Department argued is not supported by the PSCW order, GMG, or the ALJ Report, is the specific size of the adjustment warranted by this risk factor. Given the changes in economic circumstances since the orders were issued and the lack of supporting information in the decisions, the PSCW's orders provide little probative and should not be relied upon.

The Department recommended the following adjustments be made to the ALJ Report.

136. In an April 2023 ~~recent~~ rate case order, the Public Service Commission of Wisconsin (PSCW) approved a 60 percent equity ratio and an 11.00 percent ROE

⁴⁴ *In re Appl. of St. Croix Valley Nat. Gas Co., Inc. for Auth. to Increase Rates for Nat. Gas Rates*, Public Service Commission of Wisconsin, Docket No. 5230-GR-109, Final Decision at 3 (Apr. 24, 2023) (St. Croix Valley Order); *In re Appl. of Midwest Nat. Gas, Inc. for Auth. to Increase Rates for Nat. Gas Rates*, Public Service Commission of Wisconsin, Docket No. 3670-GR-106, Final Decision at 3 (Apr. 27, 2023) (Midwest Natural Order).

⁴⁵ Department Exceptions at 8, citing from the Commission's Xcel Energy rate case order in docket No. E-002/GR-21-630.

⁴⁶ *Id.*

⁴⁷ *In re Appl. of Minn. Power for Auth. to Increase Rates for Elec. Serv. in Minn.*, Docket No. E-015/GR-21-335, FINDINGS OF FACT, CONCLUSIONS, AND ORDER at 45 (Feb. 28, 2023). Staff notes that the remainder of the quote states "they do provide a check, of sorts, on reasonableness."

⁴⁸ Ex. DOC-201 at 62 (Addonizio Direct).

for St. Croix Valley, agreeing with PSCW Staff that an 11.00 percent ROE was “a reasonable level to balance the needs of customers and investors” and “remains reasonable in comparison to the returns authorized for [St. Croix Valley’s] peers.”

139. The ROE determinations in both St. Croix Valley and Midwest Natural Gas recognize that investing in smaller utilities can present higher risks than other comparable investment opportunities.

140. The experience of smaller gas utilities serving customers in rural midwestern communities, within 100 miles of the Company’s service area, ~~is~~ could potentially be helpful and instructive. Here, however, ~~Though the PSCW may have different procedures and approaches than the Minnesota Commission, the recent~~ more than two year old ROE awards to St. Croix Valley and Midwest Natural Gas clearly are not, in the phrasing of Bluefield, returns that are “generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties.”

140a. The Commission has explained that order from other jurisdictions “have limited persuasive value because of the fact-intensive nature of cost-of-equity decision-making.” The PSCW’s orders in St. Croix Valley and Midwest Natural Gas did not include any information about which utilities it considered to be “peers” to St. Croix Valley or Midwest Natural, which financial models—if any—it used in its independent economic analysis, which conditions or factors it took into consideration, or what adjustments it made based on those judgments. As a result, those orders hold no persuasive value because they do not provide any fact-specific analysis that would allow a reasoned comparison with the facts of this case.

141. The ~~“corresponding risks and uncertainties”~~ faced by risks arising from St. Croix Valley’s and Midwest Natural Gas’s small size and illiquid investments are more like those of GMG than those faced by Minnesota’s larger, urban natural gas utilities. However, St. Croix Valley and Midwest Natural Gas are not publicly traded, and therefore were not included in either the Department’s or GMG’s proxy groups. ~~Further,~~ Department witness Craig Addonizio (Addonizio) selected a group of publicly-traded proxy companies which are in the same line of business, and therefore likely have similar risks, for comparison to GMG., ~~but~~

141a. GMG utilized a proxy group of three companies, with two companies overlapping between GMG’s proxy list and the Department’s proxy list. The third company, UGI Corporation, included in GMG’s proxy list typically earns less than 20 percent of its annual operating income from regulated retail utility operations and thus presents a significantly different risk profile than GMG. Three other companies similar to GMG in risk profile were not included in GMG’s proxy list but were included in the DOC proxy list.

141b. The members of the Department's proxy group of price-regulated companies are reasonably comparable to GMG with respect to investment risk and, accordingly, the proxy group provides a reasonable basis for estimating GMG's cost of equity. GMG has failed to show that the companies making up its proposed proxy group present investment risks comparable to those of GMG and that the three companies included in DOC's proxy group but missing from GMG's proxy list should not be used to estimate GMG's cost of equity.

141c. Addonizio acknowledged that GMG is much smaller than the selected proxy group, is too small for its stock to be traded on a major stock exchange, and has debt that is personally guaranteed by certain stockholders resulting in greater risk and a higher cost of equity. He explained that he increased his recommended ROE for GMG by around 35 to 45 basis points to fairly compensate investors for those risks.

144. Addonizio estimated that for a gas utility of average risk, a reasonable authorized ROE may be around 9.2 or 9.3 percent. After considering ~~some of~~ the special risks faced by GMG, he arrived at the recommended 9.65 percent ROE. Addonizio also explained why some of the reasons GMG identified as supporting its requested ROE were inappropriate to take into account. Sales volatility risks can be mitigated through diversification, so investors do not require additional returns for such a risk. The reinvestment of earnings enhances the Company's ability to pay future dividends, and therefore also does not require increased returns. GMG did not provide any response to the Department's expert analysis explaining why these factors did not justify a higher ROE.

~~153. The hearing record shows that GMG is significantly riskier than the proxy group companies used in these DCF analyses, demonstrating the conservative nature of looking to "mean average" results from the proxy group to determine GMG's ROE. Specifically:~~

- ~~(1) — GMG is only between 0.3 percent and 1.34 percent the size of the proxy group companies meaning, among other things, less diverse revenue streams;~~
- ~~(2) — because GMG is not publicly traded, it is harder for shareholders to sell their stock if desired, and harder for GMG to issue new equity;~~
- ~~(3) — GMG has never paid a dividend, choosing instead to reinvest all earnings in the Company to meet its capital requirements; and~~
- ~~(4) — GMG's revenue streams are closely linked to demand from poultry and grain drying businesses, which adds significant volatility and risk to its business.~~

154. Each of these factors indicates that investments in GMG carry more risk than investments in the proxy companies, indicating a higher required ROE to compensate investors for that additional risk.

6. Staff Analysis

The issue of whether GMG faces increased risk due to its small size is uncontested. Both the Department and GMG agreed that the Company does face increased risk due to its small size. The issue is how much of an increase to its ROE is GMG entitled. The Department indicated that the risk premium is between 35 to 45 basis points.⁴⁹ Staff notes that the ALJ agreed with both GMG and the Department that GMG faced additional risk factors but did not settle on a specific risk premium figure. Rather, the ALJ agreed generally with GMG's claims of increased risk. The Commission may, but is not required to, individually decide each of the risk factors. The Commission may find it more efficient to not assign a specific basis point increase and rather include a general statement that the increased risk faced by GMG is accounted for in the overall approved ROE. The Commission may wish to explore this issue further during the October 9th agenda meeting.

7. Decision Options for Risk Unique to GMG

314. Adopt the ALJ Report's analysis considering GMG's risk factors and determine that the Company is significantly riskier than larger natural gas utilities. [GMG, ALJ]

Or

315. Determine that the ALJ Report erred in relying upon the two orders from the Public Service Commission of Wisconsin and decline to the decisions of other jurisdictions are not binding and have limited persuasive value because of the fact-intensive nature of cost-of-equity decision-making. [Department]

[If the Commission makes this determination, it may want to adopt one or more of the following recommended by the Department:]

- a. Replace ALJ Findings 136, 140, 141, and 144 with Department's proposed language.
- b. Adopt the Department's proposed Findings 140a, 141a-c.
- c. Reject ALJ Findings 139 and 154.

Or

316. Determine that no specific decision on risk factors is required.

F. Flotation Costs

1. Introduction

Flotation costs are the costs associated with the issuance of new securities, such as stocks or bonds. These costs include out-of-pocket expenditures for preparation, filing, underwriting, and other issuance costs. Regarding flotation costs associated with GMG debt issuances, the parties

⁴⁹ Ex. DOC-201 at 62-63, 75 (Addonizio Direct).

agreed to a 15-basis point adjustment to GMG's cost of long-term debt.⁵⁰ However, the parties dispute the need for a flotation cost adjustment to GMG's cost of equity. An example is set forth below.

If a company issues \$1 million worth of new common stock and incurs flotation costs of four percent, the company's net proceeds from the issuance are only \$960,000. Because the company will have only the net proceeds from the issuance available to invest in its operations, the company's rate base will be only \$960,000. If the company's equity investors require a 10 percent annual return on their gross investment of \$1 million (i.e., \$100,000 per year), setting the company's authorized return on equity at 10 percent would result in under-earning, as applying a 10 percent ROE to a \$960,000 rate base would produce only \$96,000 per year. The flotation cost adjustment corrects for this difference between historic gross and net proceeds from equity issuances.⁵¹

As previously discussed, there are two ways a company can pay for flotations costs. They can be deducted from the proceeds of an issuance, in which case they do not appear directly on the company's income statement and create a permanent reduction in the amount of equity recorded on the company's balance sheet; or they can be paid for directly by the company, in which case they are reflected as an expense on the company's income statement. GMG has historically expensed costs for past equity placements.

Since GMG and the Department agreed to a 15-basis point adjustment for Cost of Debt,⁵² the following discussion concerns the amount of flotation costs for equity issuances.

2. Case Record

ALJ Report ¶¶ 157-167
 Ex. GMG-103 at 12 (Palmer Direct)
 Ex. GMG-104, Schedule D-1 (Initial Filing – Volume 3)
 Ex. GMG-112 at 16-17 (Palmer Rebuttal)
 GMG Initial Brief at 26-29
 GMG Reply Brief at 11-12
 Ex. DOC-201 at 38 (Addonizio Direct)
 Ex. DOC-203 at 5-6 (Addonizio Surrebuttal)
 Department Initial Brief at 16-17
 Department Reply Brief at 8-9
 Department Exceptions to ALJ Report at 14-15

⁵⁰ Ex. JOINT-001 Resolved Issues List.

⁵¹ Ex. DOC-203 at 6 (Addonizio Surrebuttal).

⁵² Ex. JOINT-001 Resolved Issues List.

3. Party Positions

a. GMG

GMG stated that due to the Company's growth and aging shareholder base that future equity offerings would be raised by deducting from future issuances rather than expensing issuance costs.⁵³

GMG argued that because the Company has not raised external equity since 2012, there is no proxy for flotation costs specifically associated with GMG equity offerings. Thus, GMG assumed a 15-basis point adjustment to the cost of equity was appropriate since it matched what was determined to be appropriate for the cost of debt.⁵⁴

In support of its request for 15 basis points added to its ROE, GMG cited a 2015 Commission order⁵⁵ from CenterPoint Energy rate case and argued that "the Commission has specifically considered this issue in the past and has tacitly acknowledged that future flotation costs may be recoverable."⁵⁶ GMG continued to argue that its 15 basis point adjustment to its cost of equity is reasonable and results in an ROE that appropriately balances the interests of GMG and its customers.

b. Department

The Department argued that flotation cost is inappropriate noting a flotation cost adjustment is only necessary to compensate investors for flotation cost incurred and deducted from the proceeds of past equity issuances.⁵⁷ Since issuance costs for GMG's existing equity were not deducted from the proceeds of those issuances, the Department argued there is no gap between GMG's gross and net issuance proceeds to account for with a flotation cost adjustment. In addition, the Department stated that plans for future equity issuances are irrelevant. Therefore, the Department concluded that no flotation cost adjustment is warranted for GMG in this rate case.

In response to GMG's argument that the 2015 CenterPoint Energy rate case Order⁵⁸ supported the Company's request for a 15-basis point adjustment to its ROE, the Department noted that the Commission denied CenterPoint Energy's request to recover flotation costs. The

⁵³ Ex. GMG-112 at 17 (Palmer Rebuttal).

⁵⁴ *Id.*

⁵⁵ *In the Matter of the Application of CenterPoint Energy Resources Corp. d/b/a CenterPoint Energy Minnesota Gas for Authority to Increase Natural Gas Rates in Minnesota*, Docket No. G-008/GR-15-424, FINDINGS OF FACT, CONCLUSIONS, AND ORDER (June 3, 2016).

⁵⁶ *Id.* at 23.

⁵⁷ Ex. DOC-203 at 6 (Addonizio Surrebuttal).

⁵⁸ *In the Matter of the Application of CenterPoint Energy Resources Corp. d/b/a CenterPoint Energy Minnesota Gas for Authority to Increase Natural Gas Rates in Minnesota*, Docket No. G-008/GR-15-424, FINDINGS OF FACT, CONCLUSIONS, AND ORDER at 43 (June 3, 2016).

Commission offered multiple reasons for its decision, including the absence of evidence in the record on “the nature, amount, and financial impact of all costs associated with any completed or planned stock issuance.”

The Department argued that the same reasoning applied to this proceeding. Although GMG has asserted that it will need to raise equity in the future, will incur costs in doing so, and does not plan to expense those costs, the only evidence it offered in support of flotation costs are basic facts about one of its past debt issuances. That information does not allow the Commission to consider the nature, amount, or financial impact of costs associated with GMG’s future equity issuances. Without this information, and information about when GMG expects to incur those costs, the Commission has no basis to determine whether it would be just and reasonable for GMG’s ratepayers to begin paying those costs now. GMG’s request for an adjustment to ROE to account for future flotation costs should be denied.⁵⁹

4. ALJ Report

The ALJ found GMG’s arguments persuasive and determined that a 15 basis point increase in ROE for flotation costs was appropriate. The ALJ noted the following in her findings:

157. “Flotation costs” are costs incurred by a company to issue debt or equity.

158. These costs include placement fees, appraisal expenses, legal fees, and registration fees. These fees must be paid in order to obtain financing but are not available to the company at the end of the placement.

159. Regarding flotation costs associated with GMG debt issuances, the parties agreed to a 15-basis point adjustment to GMG’s cost of long-term debt. However, the parties dispute the need for a flotation cost adjustment to GMG’s cost of equity.

160. To account for flotation costs associated with equity issuances, in past cases the Commission has included an allowance for “flotation costs” in a utility’s ROE. GMG requests a similar 15-basis point equity flotation costs adjustment as applied to its cost of long-term debt, bringing its final ROE request to 10.15 percent. This request is still below the mean average of the Department’s two-growth DCF results.

161. The Department objected to inclusion of flotation costs on the grounds that the Company has expensed the cost of past equity placements. In its view, GMG’s “plans for future issuances are largely irrelevant.”

162. GMG acknowledges that, in the past, the Company expensed the cost of equity placements. Those offerings were small, and GMG staff performed a significant amount of the work in advance of the offerings.

⁵⁹ Department Reply Brief at 9.

163. Going forward, however, GMG will not complete future equity offerings in this same manner. Due to GMG's growth and its aging shareholder base, the Company will need to attract "external equity" – which it maintains will be a costly undertaking.

164. Failure to recognize these expenses will limit GMG's ability to attract sufficient capital in the future.

165. For this reason, GMG recommended a 15-basis point adjustment to the cost of equity. This addition matches the flotation adjustment that the Department and GMG agree is appropriate when the Company issues new debt.

166. Because the Company has not raised external equity since 2012, there is no proxy for flotation costs specifically associated with GMG equity offerings. Under these circumstances, and given GMG's unique financing needs, the cost of acquisition for long-term debt represents the best proxy for GMG's acquisition of equity.

167. The 15-basis point flotation cost adjustment requested by GMG is reasonable and results in an overall ROE of 10.15 percent. This adjusted figure is still lower than the mean return indicated by the two-growth DCF analyses in the record.

5. Exceptions

a. GMG

GMG submitted exceptions supporting the ALJ's factual findings and legal conclusions.

b. Department

The Department argued that the ALJ Report is theoretically and mathematically flawed. The Department noted that the Commission has previously rejected other utilities' attempts to recover hypothetical future equity flotation costs from ratepayers. The Department referenced a 2015 CenterPoint Energy rate case decision noting that the Commission explained, it is inappropriate to authorize flotation costs when there is no evidence in the record on "the nature, amount, and financial impact of all costs associated with any completed or planned stock issuance" for which the utility is seeking recovery. GMG has not offered any evidence into the record about plans for future equity offers or the costs that would be incurred in such an offering. The Department reiterated its argument that GMG has already recovered its flotation costs for its existing equity and allowing recovery of flotation costs would result in ratepayers paying a second time for those costs. The Report's finding that GMG is entitled to recover flotation costs is unsupported by the record and should be rejected.

The Department recommends the following adjustments be made to the ALJ Report.

160. To account for flotation costs associated with equity issuances, in past cases the Commission has included an allowance for "flotation costs" in a utility's ROE. GMG requests a similar 15-basis point equity flotation costs adjustment as applied

to its cost of long-term debt, bringing its final ROE request to 10.15 percent. ~~This request is still below the mean average of the Department's two growth DCF results.~~

161. The Department objected to inclusion of flotation costs for GMG's equity on the grounds that the Company has expensed the cost of past equity placements, and GMG's request would therefore be charging ratepayers a second time for flotation costs GMG has already recovered. In its view, GMG's "plans for future issuances are largely irrelevant" because "[a] flotation cost adjustment is necessary to fairly compensate investors for flotation costs incurred and deducted from the proceeds of past equity issuances."

163a. As the Commission has explained, it is inappropriate to authorize flotation costs when there is no evidence in the record on "the nature, amount, and financial impact of all costs associated with any completed or planned stock issuance" for which the utility is seeking recovery. Because GMG has not offered any such evidence in the record, its request to adjust its ROE for flotation costs is denied.

164. Failure to recognize these expenses will limit GMG's ability to attract sufficient capital in the future.

165. For this reason, GMG recommended a 15-basis point adjustment to the cost of equity. This addition matches the flotation adjustment that the Department and GMG agree is appropriate when the Company issues new debt.

166. Because the Company has not raised external equity since 2012, there is no proxy for flotation costs specifically associated with GMG equity offerings. Under these circumstances, and given GMG's unique financing needs, the cost of acquisition for long-term debt represents the best proxy for GMG's acquisition of equity.

167. The 15-basis point flotation cost adjustment requested by GMG is reasonable and results in an overall ROE of 10.15 percent. This adjusted figure is still lower than the mean return indicated by the two-growth DCF analyses in the record.

6. Staff Analysis

GMG defined flotation costs as "costs incurred by a company to issue debt or equity. These costs include placement fees, appraisal expenses, legal fees, and registration fees and they must be paid to get the financing but are not available to the company at the end of the placement."⁶⁰

⁶⁰ GMG Initial Brief at 26-27.

The Department defined flotation costs as being “necessary to fairly compensate investors for flotation costs incurred and deducted from the proceeds of past equity issuances.”⁶¹

The issue of flotation in the instant proceeding bears several similarities to the issue discussed in CenterPoint Energy’s 2015 rate case. In the CenterPoint Energy rate case, CenterPoint Energy hadn’t issued securities for several years, specifically 2010⁶² for GMG it has been 2012.⁶³ Similarly, neither utility was able to articulate when it planned to issue stock in the foreseeable future.

Staff notes in CenterPoint Energy’s 2015 rate case order (2015 Order), the Commission decided not to include a flotation adjustment in CenterPoint Energy’s cost of equity, since the Company’s parent had not issued stock since 2010 and stated that it had no plans to issue stock in the reasonably foreseeable future.⁶⁴

Additionally, the 2015 Order noted that “flotation costs are sometimes added to the cost of equity to reflect the fact that companies do not receive the full price of the stock they issue—the amount they receive is less than the face value of the stock due to legal and issuance fees incurred out-of-pocket and underwriting fees withheld from the proceeds paid to the company. Flotation costs in the amount of these fees are sometimes added to the cost of equity to credit the company with the full amount of the issuance.”⁶⁵

In its Petition, GMG maintained that due to its growth and aging shareholder base, future equity offerings will no longer be expensed. Instead, they will be deducted from the proceeds of an issuance.⁶⁶ However, GMG did not articulate when a future offering would be issued and therefore, the Commission may not have the required information to consider the nature, amount, or financial impact of costs associated with a future equity issuance.

Staff notes that the record in this proceeding shows that GMG expensed the cost of placement and other expenses of past equity issuances and has fully recovered these costs.⁶⁷ Thus, there is no shortfall currently that GMG needs to recover.

⁶¹ Ex. DOC-203 at 6 (Addonizio Surrebuttal).

⁶² *In the Matter of the Application of CenterPoint Energy Resources Corp. d/b/a CenterPoint Energy Minnesota Gas for Authority to Increase Natural Gas Rates in Minnesota*, Docket No. G-008/GR-15-424, FINDINGS OF FACT, CONCLUSIONS, AND ORDER at 43 (June 3, 2016).

⁶³ Ex. GMG-112 at 17 (Palmer Rebuttal).

⁶⁴ *In the Matter of the Application of CenterPoint Energy Resources Corp. d/b/a CenterPoint Energy Minnesota Gas for Authority to Increase Natural Gas Rates in Minnesota*, Docket No. G-008/GR-15-424, FINDINGS OF FACT, CONCLUSIONS, AND ORDER at 43 (June 3, 2016).

⁶⁵ *Id.*

⁶⁶ Ex. GMG-112 at 17 (Palmer Rebuttal).

⁶⁷ *Id.*

Should the Commission determine that the record does not support the addition of flotation costs GMG may request recovery of any future equity issuances in a future rate case. The Commission may choose to further explore this issue at its October 9th agenda meeting.

7. Decision Options for Flotation Cost Adjustment

317. Adopt the proposed flotation cost adjustment of 15 basis points. [GMG, ALJ]

Or

318. Find that the record does not support the addition of flotation costs and deny GMG's request for a flotation cost adjustment. [Department]

[If the Commission makes this determination, it may want to adopt the following as recommended by the Department.]

- a. Replace ALJ Finding 160 with the Department's proposed language.
- b. Replace ALJ Finding 161 with the Department's proposed language.
- c. Adopt the Department's Proposed Finding 163a.
- d. Delete ALJ Findings 164-167.

VII. Overall Cost of Capital

If the Commission has made specific findings regarding capital and the component costs, it does not need to make a specific finding on the overall cost of capital. However, to avoid possible confusion or questions regarding the Commission's decision, it may want to adopt a specific cost of capital (Rate of Return) for this proceeding.

Commission options regarding the overall cost of capital are:

319. Adopt an overall cost of capital of 7.92 percent reflecting GMG's 10 percent cost of equity and additional 15 basis points of flotation costs, for a total ROE of 10.15 percent. [GMG, ALJ]

Or

320. Adopt an overall cost of capital of 7.68 percent reflecting the Department's 9.65 percent cost of equity with no flotation costs. [Department]

Or

321. Delegate authority to the Executive Secretary to calculate the overall cost of capital, based on the component parts selected above, for inclusion in the order.

Or

322. Determine that no specific decision on cost of capital is required.

VIII. Decision Options

Capital Structure

301. Adopt the Company's proposed capital structure comprised of 50.44 percent long-term debt, 0.68 percent short-term debt, and 48.87 percent common equity. [GMG, Department, ALJ]

Cost of Debt

Long-Term Debt

302. Adopt the proposed cost of long-term debt of 5.76 percent. [GMG, Department, ALJ]

Short-Term Debt

303. Adopt the proposed cost of short-term debt of 8.00 percent. [GMG, Department, ALJ]

Cost of Equity

Analytical Models

304. Determine that no single model is appropriate for estimating the cost of equity.

Or

305. Determine that the constant-growth Discounted Cash Flow model, checked for reasonableness, is the most appropriate method for estimating the cost of equity.

Or

306. Determine that the two-growth Discounted Cash Flow model, checked for reasonableness, is the most appropriate method for estimating the cost of equity. [GMG, ALJ]

Or

307. Determine that the multi-stage Discounted Cash Flow model, checked for reasonableness, is the most appropriate method for estimating the cost of equity. [Department]

Return on Equity

308. Adopt GMG's proposed 10.00 percent return on equity for setting rates in this proceeding. [GMG, ALJ]

Or

309. Adopt the Department's proposed 9.65 percent return on equity for setting rate in this proceeding. [Department]

[If the Commission makes this determination, it may want to adopt one or more of the following recommended by the Department:]

- a. Replace ALJ Findings 145, 149-152, and 156 with Department's proposed language.
- b. Reject ALJ Findings 146-148, 155.

Or

310. Determine that another return on equity is appropriate for setting rates in this proceeding.

Proxy Groups

311. Adopt GMG's proposed proxy group.

Or

312. Adopt the Department's proposed proxy group.

Or

313. Take no action on the recommendation of a proxy group.

Risk Factors

314. Adopt the ALJ Report's analysis considering GMG's risk factors and determine that the Company is significantly riskier than larger natural gas utilities. [GMG, ALJ]

Or

315. Reject the ALJ Report's analysis of GMG's risk factors and its reliance on the two orders from the Public Service Commission of Wisconsin. [Department]

[If the Commission makes this determination, it may want to adopt one or more of the following recommended by the Department:]

- a. Replace ALJ Findings 136, 140, 141, and 144 with Department's proposed language.
- b. Adopt the Department's proposed Findings 140a, 141a-c.
- c. Reject ALJ Findings 139 and 154.

Or

316. Determine that no specific decision on risk factors is required.

Flotation Costs

317. Adopt the proposed flotation cost adjustment of 15 basis points. [GMG, ALJ]

Or

318. Find that the record does not support the addition of flotation costs and deny GMG's request for a flotation cost adjustment. [Department]

[If the Commission makes this determination, it may want to adopt the following as recommended by the Department.]

- a. Replace ALJ Finding 160 with the Department's proposed language.
- b. Replace ALJ Finding 161 with the Department's proposed language.
- c. Adopt the Department's Proposed Finding 163a
- d. Delete ALJ Findings 164-167.

Overall Cost of Capital

319. Adopt an overall cost of capital of 7.92 percent reflecting GMG's 10 percent cost of equity and additional 15 basis points of flotation costs, for a total ROE of 10.15 percent. [GMG, ALJ]

Or

320. Adopt an overall cost of capital of 7.68 percent reflecting the Department's 9.65 percent cost of equity with no flotation costs. [Department]

Or

321. Delegate authority to the Executive Secretary to calculate the overall cost of capital, based on the component parts selected above, for inclusion in the order.

Or

322. Determine that no specific decision on cost of capital is required.