COMMERCE DEPARTMENT

April 20, 2020

Will Seuffert
Executive Secretary
Minnesota Public Utilities Commission
121 7th Place East, Suite 350
Saint Paul, Minnesota 55101-2147

RE: **Comments of the Minnesota Department of Commerce, Division of Energy Resources**
Docket No. E015/S-20-279

Dear Mr. Seuffert:

Attached are the Comments of the Minnesota Department of Commerce, Division of Energy Resources (Department), in the following matter:

> Petition of Minnesota Power for Approval of ALLETE's 2020 Consolidated Capital Structure.

The Petition was filed on February 13, 2020 by:

> Lori Hoyum
> Regulatory Compliance Administrator
> Minnesota Power
> 30 West Superior Street
> Duluth, Minnesota 55802
> (218) 355-3601
> lhoyum@mnpower.com.

The Department requests additional information from Minnesota Power and will provide its final recommendations to the Minnesota Public Utilities Commission (Commission) after reviewing Minnesota Power's reply comments. The Department is available to answer any questions that the Commission may have in this matter.

Sincerely,

/s/ STEPHEN COLLINS
Rates Analyst
SC/ja
Attachment

Before the Minnesota Public Utilities Commission

Comments of the Minnesota Department of Commerce
Division of Energy Resources

Docket No. E015/S-20-279

I. INTRODUCTION

On February 13, 2020, Minnesota Power (MP) filed a petition requesting approval of the 2020 consolidated capital structure for ALLETE, Inc. (ALLETE). For ALLETE, the petition requests that the Minnesota Public Utilities Commission (Commission) grant:

- An equity ratio of 51.48% to 69.64% -- derived from a midpoint of 60.56% plus or minus a "contingency" band of 15 percent of this midpoint (+ or - 9.084%);
- A maximum capitalization of up to $6.145 billion – derived from an expected capitalization of $5.586 billion plus a 10% contingency amount of $0.559 billion;
- Continuation of the variance of Minn. Rules 7825.1000, subp. 6 to allow ALLETE to treat borrowing under multi-year credit agreements as short-term debt for approved capital structure purposes;
- Approval to issue short-term debt up to 15% of total capitalization;
- Authorization to issue securities, provided that ALLETE does not exceed the limits of the approved equity ratio, maximum short-term debt ratio, or maximum capitalization for more than 60 days.

In effect, these requests would allow ALLETE to reach up to $2.982 billion ([1 – 51.48%] * $6.145 billion) of debt outstanding or exceed this amount for no more than 60 days without Commission approval through a new petition.

MP requests that any rulings in this docket be effective starting on the date of issuance of an Order in this docket through the latter of (i) May 1, 2021 or (ii) the date at which the Commission issues a subsequent Order.

The Minnesota Department of Commerce, Division of Energy Resources (Department) reviews these requests below.

II. DEPARTMENT ANALYSIS

The Commission approved the most recent ALLETE capital structure in an Order issued November 7, 2019 (the 2019 Capital Structure Order), which is provided as Attachment 1 to these comments.[1] That Order approved:

- An equity ratio of 50.76% to 62.04% -- derived from a midpoint of 56.4% plus or minus a contingency band of 10 percent of this midpoint (+ or – 5.64%);[2]
- A maximum capitalization of $5.235 billion, consisting of an expected capitalization of $4.755 billion plus a contingency amount of $0.480 billion, or 10% of the expected capitalization;
- Continuation of a variance to Minn. Rules 7825.1000, subp. 6 to allow ALLETE to treat borrowings under multi-year credit agreements as short-term debt;
- Allowance for ALLETE to issue short-term debt up to 15% of total capitalization;
- Authorization to issue securities provided that ALLETE does not exceed the preceding capital structure parameters for more than 60 days.

As such, MP's request for ALLETE this year is the same except for:

a) The requested equity ratio range is based on a slightly higher midpoint -- 60.56% instead of last year's 56.4% -- and uses a +/- 15% contingency method instead of a +/- 10% method; resulting in a total requested range of 51.48% to 69.64% (versus 50.76% to 62.04% last year); and
b) The requested maximum capitalization is about 17% higher – from $5.235 billion last year to $6.145 billion this year – though it uses the same 10% contingency method.

The Department concludes that it is reasonable to maintain the long-standing policies regarding issuing short-term debt up to 15% of total capitalization, the requested variance of 7825.1000, subp. 6, and the 60-day window. As these issues have been discussed at length in prior capital structure dockets and Orders such as the 2019 Capital Structure Order provided as Attachment 1, the Department does not repeat the same discussion here.[3]

The Department reviews the remaining requests below.

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[1] Order Approving Capital Structure and Setting Reporting Requirements issued November 7, 2019 in Docket No. E015/S-19-170.

[2] The Commission's Order states that upper bound is 60.24%, but this is a typo with the "0" and "2" in reverse order. The correct upper bound is 56.4%*(1+10%) = 62.04%.

[3] For ease of reference, the Department notes that, in the 2019 Capital Structure Order: (a) the requested variance of 7825.100, subp. 6 is discussed in section IV ("Rule Variance"), the 15% debt cap and 60 day window is discussed in the paragraph beginning "In reviewing the Company's proposal" on page 3 and section III ("Commission Action").

The ratio of net debt (debt minus cash and cash equivalents) to earnings before interest taxes and depreciation (EBITDA) indicates the minimum years needed for a business to pay back its current level of debt principal assuming constant EBITDA. In 2019, 2018, and 2017, ALLETE generated EBITDA of $382, $407, and $403 million, respectively.[4] Adjusting for the divestiture of U.S. Water Services (which accounted for about 11% of ALLETE's operating revenue in 2018 and 2017) on March 26, 2019, EBITDA therefore has been roughly stable over the past three years. The net-debt to EBITDA ratios for 2019, 2018, and 2017 were 4.1, 3.5., and 3.5, respectively.[5] Therefore, ALLETE's relative leverage increased by 16% in 2019 from 2018 (4.1 divided by 3.5 minus 1). A ratio over 4.0 or 5.0 is generally considered high, but may be an appropriate level depending on whether EBITDA is expected to increase and the certainty regarding future EBITDA.

At ALLETE's requested maximum debt level of $2.982 billion,[6] ALLETE would be allowed to reach a net-debt/EBITDA ratio as high as around 7.6.[7] In comparison, at last year's approved maximum debt level of $2.578 billion,[8] ALLETE was allowed to increase its net-debt/EBITDA ratio to a maximum of 6.6, which is on the high side, but relatively understandable given the potential need for financial flexibility.

Given the implied increase of the net-debt/EBITDA ratio from 6.6 to 7.6 at ALLETE's new requested capital structure parameters, the Department requests that MP provide more information (beyond what is included in the petition) about why granting ALLETE the option to increase its relative leverage – and to increase the maximum debt outstanding to $2.982 billion -- would be reasonable and needed. In particular, the Department requests more information about ALLETE's non-regulated capital expenditures in particular as described in Exhibits J and L to the petition, the prudent level of debt needed to finance these expenditures, and what measures ALLETE is taking to insulate Minnesota Power and its ratepayers from the debt incurred to pursue non-regulated lines of business. The Department also requests that MP reconcile the information provided in Exhibits J and L to the following statements made by management in ALLETE's February 13, 2020 earnings call:

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[4] The Department defines EBITDA as operating income with depreciation and amortization added back. An alternative way to define EBITDA is net income with interest, taxes, depreciation, and amortization added back; however, due to ability of unusual gains/sales of assets to affect net income, the Department's methodology more accurately represents normalized ability to pay back debt.

[5] As the net-debt/EBITDA ratio is an amount of dollars divided by another amount of dollars, the result is a unitless number. Nonetheless, the ratio indicates the minimum number of years needed to pay back the current level of debt principal assuming constant EBITDA.

[6] $2.982 billion = (1-51.48%) * the requested $6.145 billion maximum capitalization. If cash and cash equivalents stay the same as 2019, which seem reasonable as they have been roughly constant the past three years, then net debt would be $2.912 billion ($2.982 billion minus 2019's $69 million in cash and cash equivalents).

[7] This ratio of 7.6 assumes that ALLETE's 2020 EBITDA is the same as 2019 EBITDA, given that EBITDA has been roughly stable the past three years.

[8] $2.578 billion = last year's maximum capitalization of $5.235 billion * (1-50.76%). The net debt is then $2.587 billion minus cash and cash equivalents of $69 million = $2.508 billion.

> Overall, ALLETE has approximately $2 billion of projects scheduled in our CapEx planned for the next five years, of which Clean Energy projects represent the vast majority. … We continue to expect minimal equity issuances, which would be required to fund the $2 billion in projected investments.

The Department also requests that MP reconcile the clarifications provided in reply comments regarding the level of debt to be used for non-regulated operations with this other statement by management on the February 13, 2020 earnings call:

> Our differentiated growth strategy is well supported by ALLETE's solid fundamentals and a longer runway of credit headroom, which will enable further non-regulated growth.

Further, the Department requests that MP provide more detailed information about the specific projects that would warrant an increase in the debt ratio (the inverse of the equity ratio) contingency range from 10% to 15% and why specifically this increased flexibility is needed and reasonable at this time.

In addition, given MP's ongoing general rate case, the Department requests that MP confirm that MP's capital structure for ratemaking purposes will not be affected by any changes regarding ALLETE's approved capital structure.

The Department will provide a recommendation on these issues after reviewing MP's reply comments.

Regarding filing requirements, the Department concludes that MP's petition is complete with respect to Minnesota administrative rules and prior Commission Orders, and that no additional filing requirements are needed at this time. In the 2019 Capital Structure Order, the Commission required the following information to be included, as indicated in Order Points 4, 5, and 6:

> 4. In future capital structure filings, Minnesota Power must include:
>
> > a. an exhibit showing a general projection of capital needs, projected expenditures, anticipated resources, and anticipated timing, with the understanding that such exhibit is not intended to require dollar-for-dollar information on the uses identified in the exhibit or to limit the issuances to project specific financing;
> >
> > b. a report of actual issuances and uses of the funds from the prior year;

c. a schedule comparing its actual capital investments with the capital investments projected by Minnesota Power in its previous capital structure filing; and

d. the Company's investment plan for at least the next five years.

5. Within 20 days after a securities issuance, Minnesota Power must file details on the specific purposes of the individual issuances, the type, timing, amounts, cost of issuance (including price per share for common equity issuances), and interest rates.

6. Within 20 days of becoming aware of any significant change in ALLETE's or Minnesota Power's credit ratings and outlook, or if either undertakes corporate restructuring, Minnesota Power must file an information update.

The Department recommends continuing to require this information as it continues to be warranted to allow for sufficient Commission oversight. In addition, the Department recommends that the Commission require MP to indicate in future capital structure petitions and compliance filings how much of any capital issuances and other activities cited are for Minnesota Power, how much is for other regulated entities, how much is for ALLETE Clean Energy, and how much is for other non-regulated entities. This additional information would enable the Commission to better understand whether ALLETE is appropriately protecting ratepayers from risk in its other lines of business, and to what extent ALLETE is taking on risk in those businesses.

Last, regarding the duration of any Order in this docket, the Department does not object to MP's request that any rulings in this docket be effective starting on the date of issuance of an Order in this docket through the latter of (i) May 1, 2021 or (ii) the date at which the Commission issues a subsequent Order.

III. RECOMMENDATION

The Department will provide a final recommendation after reviewing MP's reply comments.

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Katie J. Sieben	Chair
Dan Lipschultz	Commissioner
Valerie Means	Commissioner
Matthew Schuerger	Commissioner
John A. Tuma	Commissioner

In the Matter of the Petition of Minnesota Power for Approval of 2019 Capital Structure and Permission to Issue Securities

ISSUE DATE: November 7, 2019

DOCKET NO. E-015/S-19-170

ORDER APPROVING CAPITAL STRUCTURE AND SETTING REPORTING REQUIREMENTS

PROCEDURAL HISTORY

On February 19, 2019, Minnesota Power (the Company), the largest division of ALLETE, filed a petition requesting approval of ALLETE's consolidated capital structure, which included a requested common equity ratio of 56.40% with a contingency range of +/- 10% (50.76% to 62.04%).

On March 19, 2019, the Department of Commerce, Division of Energy Resources (the Department) filed comments recommending that the Commission approve the capital structure filing, set reporting requirements for future filings, and direct the Company to file information on the difference between ALLETE's actual and projected 2018 capital expenditures as set forth in the Company's prior capital structure filing.[1]

On March 27, 2019, the Company filed reply comments addressing the Department's request for additional information.

On June 24, 2019, the Company filed a modification to its February 19 filing, requesting that a common equity ratio of 56.40% be approved with a contingency range of 10% below the equity ratio but without a maximum cap above the equity ratio.

On July 31, 2019, the Department filed comments recommending that the Commission deny the Company's request to remove the cap on its equity ratio contingency range.

On September 19, 2019, the matter came before the Commission.

[1] *In the Matter of a Petition by Minnesota Power (MP) for Approval of its 2018 Capital Structure and Authorization to Issue Securities*, Docket No. E-015/S-18-155.

FINDINGS AND CONCLUSIONS

I. The Petition

Minnesota Power filed its petition under Minn. Stat. § 216B.49 and Minn. R. 7825.1000–.1500, which govern utilities' capital structure filings.

The Company requested a common equity ratio of 56.40%, with a contingency window of +/- 10% (50.76% to 62.04%), and a total consolidated capitalization of $5,235 million, including a contingency reserve of $480 million. The proposal is detailed in the table below

Projected Consolidated Capital Structure June 30, 2020 ($ Millions)		
	Amount	**Percentage**
Long - Term Debt	$ 2,073	43.60%
Short - Term Debt	$ 0	0.00%
Total Equity	$ 2,682	56.40%
Projected Capitalization	$ 4,755	100.00%
Contingency	$ 480	
Total Request	**$ 5,235**	

The proposal, according to the Company, reflects significant construction and infrastructure development that is underway. Projected investments and spending for 2019 and 2020 include capital investments to meet safety, environmental, regulatory, and system reliability objectives.

As part of its proposal, the Company requested to issue short-term debt not exceeding 15% of total capitalization. The issuances of short-term debt, the Company stated, would take the form of traditional instruments such as borrowings that mature within one year, but the Company also requested a continuation of a variance previously granted that would authorize the Company to treat issuances of debt under multi-year credit agreements as short-term debt.

Minnesota Power additionally requested authorization to issue long-term debt within the capitalization ratios and limits. In its initial filing, the Company stated that the +/- 10% equity ratio contingency range would provide needed flexibility to manage capital expenditures and financing plans, as well as unexpected events, such as changes in economic conditions, major plant repairs, refinancing, and variations in forecasted expenditures. Any securities issuance that falls outside the range for longer than 60 days would require Commission approval. The Company ultimately modified its initial request, stating that removing the equity cap on its contingency range would enable ALLETE to carry more equity to meet financial thresholds and the expectations of ratings agencies. Removing the cap, the Company stated, would have no financial effect on Minnesota Power's customers.

II. Comments of the Department

The Department recommended that the Commission approve the Company's capital structure, as initially proposed, with additional reporting requirements for future capital structure filings.

The Department stated that the proposed total capitalization, along with a contingency cap of $480 million, would enable the Company to fund existing operations as well as the acquisition of related businesses.

In comparing Minnesota Power's proposed equity ratio to those of other electric utilities that are risk-comparable, the Department's analysis showed that the comparison group's average equity ratio was 44.36%, and that its average long-term debt ratio was 50.65%. Minnesota Power's proposal included a higher-than-average equity ratio and a lower-than-average debt ratio, avoiding potential financial risks associated with a low equity ratio.

Although a higher equity ratio is generally associated with lower financial risks, the Department noted that an unreasonably high equity ratio could increase the Company's cost of capital. Further, the Department stated that ALLETE's non-regulated revenue (25% of 2017 operating revenue) and its high concentration of large industrial customers cause ALLETE to be a higher investment risk than Minnesota Power. The Department ultimately stated that the Company's proposal is reasonable and recommended its approval, while pointing out that any future capital structure proposal, including in a general rate case filing, would be separately scrutinized.

The Department also recommended approval of the Company's originally proposed +/-10% contingency range, stating that it reasonably balances the need for financial flexibility and regulatory oversight and is consistent with the Commission's decision in the Company's prior capital structure filing.

The Department was not persuaded that Minnesota Power had demonstrated a need that would justify removing the 10% cap on the equity ratio, as the Company later requested. Without a clear basis for the proposed modification, such as a detailed explanation of changes in circumstances, the Department recommended against removing the cap. The flexibility of the range is sufficient, according to the Department's analysis, which showed that if the Company were in need of additional capital, it could increase its total equity by up to $1.1 billion, and remain within the contingency range, if it reduced its planned long-term debt issuance from $587 to $501 million.

In reviewing the Company's proposal to issue short-term debt that does not exceed 15% of total capitalization during the authorization period, the Department stated that the cap is reasonble because it would allow the Company to meet short-term fluctuations in revenues and expenditures.

Finally, the Department recommended that in future capital structure filings Minnesota Power include:

a. an exhibit showing a general projection of capital needs, projected expenditures, anticipated resources, and anticipated timing, with the understanding that such exhibit is not intended to require dollar-for-dollar information on the uses identified in the exhibit or to limit the issuances to project specific financing;

b. report of actual issuances and uses of the funds from the prior year;

c. a schedule comparing its actual capital investments with the capital investments projected by Minnesota Power in its previous capital structure filing; and

d. the Company's investment plan for at least the next five years.

III. Commission Action

The Commission is persuaded by the Department's analysis that the filing as initially proposed is reasonable and will therefore approve it.

In particular, the Commission concurs with the Department's recommendation on the equity ratio contingency range of +/-10% on 56.40%, which the Company initially proposed. The Department explained that the range sets a reasonble cap of 62.04, which the Company may not exceed for more than 60 days without Commission authorization. The flexibility of the range is sufficient, according to the Department's analysis, which showed that if Minnesota Power reduced its long-term debt issuance, the Company could obtain more than twice the amount of its proposed equity increase while remaining within the +/-10% equity ratio contingency range.

Removing the cap, as Minnesota Power proposed, would in effect render meaningless the equity ratio itself. The cap triggers regulatory oversight if the Company's equity percentage increases or decreases outside the contingency range for longer than 60 days. If there were no limit on the upper range, the Company could increase its equity to any percentage for any period of time during the year without scrutiny. The importance of the cap is its protection of ratepayers and the Company by ensuring regulatory review of changes significant enough to potentially affect the Company's cost of capital or financial risk level. For these reasons, the Commission will approve the +/-10% equity ratio contingency range.

The Commission will approve the Company's proposed capital structure filing for the reasons explained herein and as set forth in the ordering paragraphs below. The Commission will also direct the Company to include in its next capital structure filing the information recommended by the Department, as set forth below.

IV. Rule Variance

Minnesota Power requested a variance to Minn. R. 7825.1000, subp. 6, which defines short-term debt as an "unsecured security with a date of maturity no more than one year from the date of issuance…" The variance would authorize the Company to treat issuances of debt under multi-year credit agreements as short-term debt. The Company stated that the conditions of a variance are met under Minn. R. 7829.3200, which directs the Commission to grant a variance, if the following conditions are met:

- Enforcement of the rule would impose an excessive burden on the applicant or others affected by the rule;

- Granting the variance would not adversely affect the public interest; and

- Granting the variance would not conflict with standards imposed by law.

First, Minnesota Power stated that the purpose and manner of the multi-year agreements are similar to traditional use of short-term securities. A lack of available short-term funding to meet unexpected needs would impose an excessive burden on the Company, ratepayers, or shareholders. Second, the Company stated that granting the variance would not adversely affect the public interest because the agreements enable the Company to maintain liquidity and fee structures for several years. That liquidity is particularly relevant to Minnesota Power's operations, which include potentially unexpected downturns in production by its large industrial customer base. Further, the Commission would retain oversight of the securities issued under the agreements. Third, granting the variance would not conflict with standards imposed by law.

The Department recommended that the Commission grant the requested variance to Minn. R. 7825.1000, subp. 6, concurring with Minnesota Power's reasoning that enforcement of the rule would impose an excessive burden on the applicant or others, including ratepayers or shareholders.

The Commission will grant the Company's request for a variance to Minn. R. 7825.1000, subp. 6, concurring with the Company and the Department that the requirements for a variance under Minn. R. 7829.3200 have been met.

ORDER

1. The Commission hereby approves Minnesota Power's filing with a $5,235 million total capitalization, $480 million capital contingency, a common equity ratio of 56.4%, and an allowed equity band of +/- 10% of the approved common equity ratio, from 50.76% to 60.24%.

2. The Commission hereby approves issuance of short-term debt up to 15% of total capitalization, and flexibility to issue securities provided that ALLETE remains within the common equity ratio band and the approved capitalization, including contingency, or does not exceed them for more than 60 days.

3. Approve continuation of a variance to Minn. R. 7825.1000, subp. 6, to allow ALLETE to continue to treat borrowing under multi-year credit agreements as short-term debt.

4. In future capital structure filings, Minnesota Power must include:

    a. an exhibit showing a general projection of capital needs, projected expenditures, anticipated resources, and anticipated timing, with the understanding that such exhibit is not intended to require dollar-for-dollar information on the uses identified in the exhibit or to limit the issuances to project specific financing;

    b. a report of actual issuances and uses of the funds from the prior year;

    c. a schedule comparing its actual capital investments with the capital investments projected by Minnesota Power in its previous capital structure filing; and

d. the Company's investment plan for at least the next five years.

5. Within 20 days after a securities issuance, Minnesota Power must file details on the specific purposes of the individual issuances, the type, timing, amounts, cost of issuance (including price per share for common equity issuances), and interest rates.

6. Within 20 days of becoming aware of any significant change in ALLETE's or Minnesota Power's credit ratings and outlook, or if either undertakes corporate restructuring, Minnesota Power must file an information update.

7. This order shall become effective immediately.

BY ORDER OF THE COMMISSION

Daniel P. Wolf
Executive Secretary

This document can be made available in alternative formats (e.g., large print or audio) by calling 651.296.0406 (voice). Persons with hearing loss or speech disabilities may call us through their preferred Telecommunications Relay Service or email consumer.puc@state.mn.us for assistance.

CERTIFICATE OF SERVICE

I, Sharon Ferguson, hereby certify that I have this day, served copies of the following document on the attached list of persons by electronic filing, certified mail, e-mail, or by depositing a true and correct copy thereof properly enveloped with postage paid in the United States Mail at St. Paul, Minnesota.

Minnesota Department of Commerce
Comments

Docket No. E015/S-20-279

Dated this **20th** day of **April 2020**

/s/Sharon Ferguson

First Name	Last Name	Email	Company Name	Address	Delivery Method	View Trade Secret	Service List Name
Linda	Chavez	linda.chavez@state.mn.us	Department of Commerce	85 7th Place E Ste 280 Saint Paul, MN 55101-2198	Electronic Service	No	OFF_SL_20-279_S-20-279
Generic Notice	Commerce Attorneys	commerce.attorneys@ag.state.mn.us	Office of the Attorney General-DOC	445 Minnesota Street Suite 1400 St. Paul, MN 55101	Electronic Service	Yes	OFF_SL_20-279_S-20-279
Sharon	Ferguson	sharon.ferguson@state.mn.us	Department of Commerce	85 7th Place E Ste 280 Saint Paul, MN 551012198	Electronic Service	No	OFF_SL_20-279_S-20-279
Lori	Hoyum	lhoyum@mnpower.com	Minnesota Power	30 West Superior Street Duluth, MN 55802	Electronic Service	No	OFF_SL_20-279_S-20-279
David	Moeller	dmoeller@allete.com	Minnesota Power	30 W Superior St Duluth, MN 558022093	Electronic Service	No	OFF_SL_20-279_S-20-279
Generic Notice	Residential Utilities Division	residential.utilities@ag.state.mn.us	Office of the Attorney General-RUD	1400 BRM Tower 445 Minnesota St St. Paul, MN 551012131	Electronic Service	Yes	OFF_SL_20-279_S-20-279
Will	Seuffert	Will.Seuffert@state.mn.us	Public Utilities Commission	121 7th Pl E Ste 350 Saint Paul, MN 55101	Electronic Service	Yes	OFF_SL_20-279_S-20-279