MINNESOTA
PUBLIC UTILITIES COMMISSION

Staff Briefing Papers

Meeting Date	April 12, 2018	Agenda Item **3
Company	**Greater Minnesota Gas, Inc.**	
Docket No.	**G-022/S-17-808**	
	In the Matter of Greater Minnesota Gas, Inc.'s Petition for Approval of 2018 Capital Structure and Permission to Issue Securities	

Issues

1. Should the Commission modify GMG's petition for approval of 2018 capital structure and permission to issue securities as recommended by the Department?
2. Should the Commission impose additional requirements on GMG's 2019 capital structure petition?

Staff Ganesh Krishnan Ganesh.krishnan@state.mn.us 651-201-2215

✓ **Relevant Documents**	**Date**
GMG Initial Filing (Non-Public)	November 15, 2017
DOC Comments (Non-Public)	February 16, 2018
GMG Reply Comments	February 23, 2018
DOC Reply Letter	March 8, 2018

I. Statement of the Issues

1. Should the Commission modify GMG's petition for approval of 2018 capital structure and permission to issue securities as recommended by the Department?

2. Should the Commission impose additional requirements on GMG's 2019 capital structure petition?

II. Background

On November 15, 2017, Greater Minnesota Gas, Inc. (GMG) filed a petition for approval of its 2018 capital structure and permission to issue securities.

GMG is seeking approval of the following:

- Total capitalization of up to $41 million, including the contingency of $695,137.
- An equity ratio floor of 31.59 percent initially and increasing to 33.0 by March 31, 2019.
- The ability to issue short-term debt not to exceed ten percent of total capitalization at any time while the 2018 capital structure is in effect.
- Long-term debt flexibility to issue securities provided that the Company remains within the contingency ranges and does not exceed them for more than 60 days.
- Approval of the 2018 capital structure until the Commission issues a 2019 capital structure Order

On February 2, 2018, the Department filed its Comments recommending approval of GMG's petition with modifications.

The Department proposes two sets of modifications.

First, regarding GMG's proposed 2018 capital structure, the Department recommends:

> a total capitalization contingency of $4.0 million (as opposed to GMG's proposed contingency of $695,137) above the estimated 2018 year-end total capitalization of $40.3 million, for a total capitalization of $44.3 million; and

Second, the Department proposes the following two requirements affecting GMG's 2019 capital structure filing as a precondition for approving the 2018 capital structure filing and request to issue securities.

Regarding GMG's 2019 capital structure and request to issue securities petition, the Department recommends that the Commission require GMG to propose:

1) a plan that would be expected to result in a 36.50 percent equity ratio by December 31, 2019, assuming normal weather, or an explanation why such an increase is not possible; and

2) a step-increase in GMG's equity ratio floor from 33.0 percent to 34.0 percent beginning March 31, 2020, or an explanation why such an increase is not possible.

On February 23, 2018, GMG filed its response to the Department's Comments.

GMG accepted the Department's modification of its proposed 2018 capital structure.

Regarding the Department's recommendation that GMG file a plan in 2019 that would achieve an equity ratio of **36.5%** by December 31, 2019 (assuming normal weather), GMG retorted that it is possible to achieve an equity ratio of **35.9%** by December 31, 2019 (assuming normal weather conditions). GMG noted its expectation that the federal Tax Cut and Jobs Act (TCJA) would reduce its equity ratio by 0.6 of a percentage point.

GMG noted that it is not feasible to consistently increase its equity ratio by one percent or more in a one-year period without raising rates. GMG suggested that the Commission authorize a plan that would result in a year-end equity ratio for GMG of 35.9%, assuming normal weather, or explain why that is not possible.

GMG indicated that requiring a step increase in equity ratio from 33 percent to 34 percent by March 31, 2020 is neither appropriate nor good public policy because future conditions are unknown. GMG suggests that the Commission consider what constitutes an appropriate 2020 equity ratio floor in when GMG's 2019 capital structure petition is filed.

On March 8, the Department filed its reply to GMG's reply comments.

The Department contended that the appropriate treatment of the TCJA and its impacts is the subject of ongoing Commission Investigation in Docket No. E,G-999/CI-17-895 (TCJA Docket). As GMG acknowledged in its Reply Comments, "the actual impact of the recent federal tax changes are still unknown." Because of this, the Department considers any adjustments to reflect the TCJA's predicted impact to be premature.

Regarding its recommendation to increase the equity balance from 33 percent to 34 percent by March 31, 2020 the Department emphasized that its recommendation is intended only to set a starting point for future capital structure petitions, not an end point. If a 34.0 percent equity ratio floor turns out to be an impossible goal, GMG will have an opportunity to explain why in future filings, and the Department will consider GMG's explanation in making its recommendations in those future dockets.

III. Issue 1: Should the Commission modify GMG's petition for approval of 2018 capital structure and permission to issue securities as recommended by the Department?

GMG's Proposal

GMG acknowledged that the Commission's May 10, 2017 Order in GMG's 2017 capital structure docket (G-022/S-16-931) required the following in GMG's 2018 capital structure filing:

> maintain an equity ratio of at least 31.59 percent at all times with a contingency range of 31.59 percent to 38.61 percent; and to
>
> propose in the 2018 capital structure filing,
>
> > a plan to that would be expected to result in a 35.00 percent equity ratio by December 31, 2018;[1] and
> >
> > a step-increase in GMG's equity ratio floor from 31.59 percent to 33.0 percent beginning March 31, 2019.

GMG's actual capitalization and debt as of September 30, 2017 and projected capitalization as of December 31, 2018 are provided below:

Type of Capital	Capital Structure as of Sep. 30, 2017		Capital Structure Projected as of Dec. 31, 2018	
Common Equity	$ 12,060,817	31.90%	$ 14,267,218	35.40%
Preferred Shares	-	0%	-	0%
Short Term Debt	$ 1,966,058	5.20%	$ 1,241,500	3.08%
Long Term Debt	$ 23,782,567	62.90%	$ 24,796,145	61.52%
Total Capitalization	$ 37,809,442	100.00%	$ 40,304,863	100.00%
Contingency			$ 695,137	
Total with Contingency			$ 41,000,000	

GMG stated that it plans to issue securities to fund capital expenditures to maintain and reinforce existing plant and to invest in new plant to support customer growth.

GMG is requesting approval to issue additional short and long term financing and contribute additional paid in capital provided GMG maintains an equity ratio floor of 31.59%, increasing the floor to 33.0 percent by March 31, 2019, and total capitalization does not exceed $41 million. GMG intends to issue long-term debt for the purpose of financing its 2018 capital projects.

GMG is requesting that it be allowed to issue short-term debt up to 10% of total capitalization to meet working capital requirements and unanticipated needs for short-term borrowing and

[1] This requirement was under the assumption of normal weather, or explain why such an increase is not possible.

accounts payable over the period. GMG notes that if short-term borrowing would exceed the ten percent cap for a period exceeding 60 days (such as borrowing for an unanticipated capital expenditure), GMG will seek approval from the Commission for any such borrowing.

GMG is seeking approval of the following specific provisions:

1) total capitalization of up to $41 million, including the contingency of $695,137;
2) an equity ratio floor of 31.59 percent initially and increasing to 33.0 by March 31, 2019;
3) the ability to issue short-term debt not to exceed ten percent of total capitalization at any time while the 2018 capital structure is in effect;
4) long-term debt flexibility to issue securities provided that the Company remain within the contingency ranges and does not exceed them for more than 60 days; and
5) approval of the 2018 capital structure until the Commission issues a 2019 capital structure Order.

Department's Analysis

The Department concluded that GMG's petition complied with all filing and reporting requirements.

The Department indicated that GMG's financial performance during 2016 and the 12 months ended September 30, 2017 was better than in 2015. GMG's operating expenses as a percentage of gross margin fell and its net operating income as a percentage of gross margin increased, which resulted in higher overall rates of return.

The Department observed that GMG's need for funds is driven by continuing system expansion efforts and that approximately 80 percent of capital expenditures planned for 2018 will go towards system expansion.

Equity Ratio Range

The Department has found GMG's request of an equity ratio contingency range of at least 31.59 percent during 2018 and the proposed increase in equity ratio floor to 33.0 percent by March 31, 2019 to be reasonable. However, the Department has specifically recommended that the Commission not grant GMG flexibility to deviate from this requirement and direct GMG to maintain an equity ratio at or above its approved floor at all times. The Department has also recommended that GMG make monthly compliance filings demonstrating that GMG's equity ratio remains at or above the approved floor.

Short-Term Debt Ratio

The Department has found GMG's request for a short-term debt contingency cap of ten percent of its total capitalization reasonable. However, the Department emphasized that GMG's equity ratio remain at or above 31.59 percent at all times. The Department recommends that the

Commission allow GMG to violate the proposed short-term debt contingency cap of ten percent for up to 60 days.

Long-term Debt Ratio

The Department highlighted that GMG did not request a specific contingency range for its long-term debt ratio but that GMG requested flexibility to issue long-term debt provided that it remains within its equity and short-term debt contingency ranges and does not exceed them for more than 60 days.

The Department noted that if GMG reduced its short-term debt ratio to zero, the maximum long-term debt ratio that would keep the Company within the proposed equity range would be 68.41 percent (equal to 100 percent minus 31.59 percent). The Department noted that GMG's proposal was reasonable.

The Department recommended that the Commission permit GMG to issue long-term debt provided that it remains within its equity contingency range at all times, and remains within its short-term debt contingency range and does not exceed it for more than 60 days.

Total capitalization

The Department recommends approval of GMG's 2018 capital structure proposal with a modification to the contingency amount. The Department noted that GMG's proposal of a contingency of $0.7 million is significantly less than the 10 percent capitalization contingency approved by the Commission in GMG's last several capital structure Dockets.

The Department concludes that a 10 percent contingency is appropriate to protect GMG from unforeseen capital needs. The Department recommends a total capitalization of $40.3 million with a 10 percent contingency ($4.0 million) for a total of $44.3 million

The following table shows the Department's proposed adjustment to GMG's proposed capital structure:

Type of Capital	GMG's Proposed 2018 Capital Structure		Department's Proposed 2018 Capital Structure	
Common Equity	$ 14,267,218	35.40%	$ 14,267,218	35.40%
Preferred Shares	-	0%	-	0%
Short Term Debt	$ 1,241,500	3.08%	$ 1,241,500	3.08%
Long Term Debt	$ 24,796,145	61.52%	$ 24,796,145	61.52%
Total Capitalization	$ 40,304,863	100.00%	$ 40,304,863	100.00%
Contingency	$ 695,137	1.72%	$ 4,000,000	10.00%
Total with Contingency	$ 41,000,000	101.72%	$ 44,304,863	110.00%

If GMG uses this total capitalization contingency, it must still maintain an equity ratio of at least 31.59 percent.

Summary of Department's Recommendations

> Staff Note: Item 5 below was not listed in the summary of the Department's recommendations; the Commission may wish to inquire of the Department whether it should be excluded.

1. approve GMG's proposed 2018 capital structure;

2. require that GMG maintain an equity ratio contingency range of at least 31.59 percent at all times, unless it can demonstrate that adjustments resulting from the Tax Cuts and Jobs Act of 2017 caused its equity ratio to fall below 31.59 percent;

3. require GMG to make monthly compliance filings on or before the 15th of each month containing a balance sheet, income statement, and cash flow statement for the first of the prior two months;

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

5. permit GMG to issue long-term debt provided that it remains within its equity contingency range at all times, and remains within its short-term debt contingency range and does not exceed it for more than 60 days;

6. approve a total capitalization contingency of $4.0 million above the estimated 2018 year-end total capitalization of $40.3 million, for a total capitalization of $44.3 million; and

7. require GMG to file a new securities issuance and capital structure petition by January 1, 2019.

GMG's Response

GMG requests that the Commission approve its 2018 capital structure and grant permission to issue securities in accordance with the limits and contingencies identified in the Department's Comments.

Decision Options

The decision options for issue #1 are at the end of the briefing papers.

IV. Issue 2: Should the Commission impose additional requirements on GMG's 2019 capital structure petition?

Department's Position

Even as the Department recommended approval of GMG's 2018 capital structure filing and permission to issue securities, the Department expressed its ongoing concern with GMG's lack of adequate equity capital in its capital structure.

While the Department recognized GMG's proposed equity ratio of 35.40 percent as a notable improvement, and acknowledged that GMG's financial performance in 2016 and 2017 was somewhat better than 2015, the Department pointed out that GMG's equity ratio was significantly lower than the average equity ratio of 45.7 percent for publicly traded gas utilities with bond ratings from A to BBB-.

In view of these concerns, the Department recommends the following additional requirements for GMG's 2019 capital structure fling:

1) a plan that would be expected to result in a 36.50 percent equity ratio by December 31, 2019, assuming normal weather, or an explanation why such an increase is not possible; and
2) a step-increase in GMG's equity ratio floor from 33.00 percent to 34.00 percent beginning March 31, 2020, or an explanation why such an increase is not possible

The Department acknowledged that its proposed target (or goal) of a 36.50 percent equity ratio by December 31, 2019, did not incorporate any adjustment for the consequences of the 2017 TCJA.

GMG's Position

In general, GMG is asking that the Commission consider the merits of its 2018 capital structure filing and request to issue securities separately from considerations affecting future capital structure filings.

1) 36.50 percent equity ratio by December 31, 2019

With regard to the proposed requirement relating to the 2019 capital structure filing, GMG requested that the Commission revise downward the Department's proposed target equity floor of 36.5% (by December 31, 2019) to 35.9%. GMG agrees to propose a plan that would result in a year-end 2019 equity ratio of 35.9%, assuming normal weather, or provide an explanation why that could not be achieved.

GMG notes that the Department's target equity ratio of 36.5% by December 31, 2019 did not incorporate any adjustment for consequences of the 2017 Federal Tax Act (TCJA). GMG is currently assuming that its equity ratio will be reduced by 0.6% as a result of the 2017 Federal Tax Act. GMG proposes that the Department's recommendation be modified to account for GMG's expectation of the impact the TCJA will have on its capital structure. GMG stated that although the actual impact of the recent federal tax changes are still unknown, it expects the

TCJA to reduce its equity ratio by 0.6 of a percentage point, and therefore requests that the Department's proposed 2019 target be reduced from 36.5 percent to 35.9 percent. GMG believes that, given normal weather conditions and a normal grain-drying season, the goal proposed by the Department is a stretch but is possible to meet if it is adjusted for the anticipated shortfall caused by Tax Act changes.

GMG claims that it has worked very hard to increase its equity ratio by approximately 1.4% over an 18 month period that includes two heating seasons. GMG does not think that it is feasible to consistently increase its equity ratio by one percent or more every year without raising its rates. GMG stressed the difficulty of increasing rates as many of GMG's customers have signed up for service within recent years and stable rates are necessary to retain the customers.

2) Step-increase in equity ratio floor from 33.00 percent to 34.0 beginning March 31, 2020

GMG also opposes the Department's advocacy of a step-increase in the equity ratio floor from 33.0 percent to 34.0 percent (or explain why such an increase is not possible) beginning March 31, 2020, in the 2019 capital structure filing. GMG considers the Department's advocacy of a 33.0 percent equity floor to be arbitrary.

GMG respectfully requests that, rather than imposing an additional equity ratio floor increase for 2020 without a record to do so, the Commission consider GMG's future equity ratio with its 2019 capital structure petition based on the most complete information then available.

Department's Response

1) 36.50 percent equity ratio by December 31, 2019

The Department reiterated that its recommendation is for GMG to propose a 2019 year-end equity ratio of 36.5 percent, or explain why such an increase is not possible.

The Department indicated that the actual impact of the recent federal tax changes are still unknown and that the appropriate treatment of the TCJA and its impact is currently the subject of the ongoing Commission investigation in the TCJA docket. Thus, Department holds that it is premature to consider any adjustments to reflect the TCJA's predicted impact.

The Department pointed out that should the operation of the TCJA render it difficult to reach a 36.5 percent equity ratio, GMG will have the opportunity to explain that in its next capital structure filing.

2) Step-increase in equity ratio floor from 33.00 percent to 34.0 beginning March 31, 2020

The Department argued that the timing of its recommendation to increase GMG's equity ratio floor was based on GMG's position in the 2017 Capital Structure Docket (G-022/S-16-931).

In that docket, the Department notes that GMG made it clear that significant changes to its proposed capital structure for 2017 would force it to alter its plans and potentially cancel planned projects, causing undue hardship to GMG. GMG also made it clear that, in its opinion, imposing an increase in its equity ratio floor in the subsequent planning year (i.e., 2018), would also present significant challenges. As a result, the Commission imposed a future requirement on GMG's capital structure filing two planning periods in the future (i.e. 2019).[2]

The Department argued that GMG's position in this docket to wait until the 2019 capital structure petition to make a decision about its 2020 equity floor directly contradicts the position GMG took in the 2017 Capital Structure Docket regarding the timing of equity increases, and it is unclear what, if anything, has changed in the last year.

In any event, the Department emphasizes, again, that its recommendation is intended only to set a starting point for future capital structure petitions, not an end point. The Department emphasized that an equity ratio of 34.0 percent is a soft (aspirational) target, not a hard target, adding that if that floor turns out to be an impossible goal, GMG simply has to explain why it was not possible to achieve that goal. The Department remarked that it would consider GMG's explanation in making its recommendations.

Decision Options

The decision options for issue #2 are at the end of the briefing papers.

[2] Staff Note: This explains why the Commission imposed a requirement of 35.00 percent equity ratio by an earlier period of December 31, 2018 and a step increase in the equity floor from 31.59 percent to 33.0 percent beginning at a much later period of March 31, 2019.

V. Decision Options

Should the Commission modify GMG's petition for approval of 2018 capital structure and permission to issue securities as recommended by the Department (Issue 1)?

1. Approve the Department's recommendations 1-7 above and add the following provision:

   approval of the 2018 capital structure until the Commission issues a 2019 capital structure Order.

2. Other action by Commission

Should the Commission impose additional requirements on GMG's 2019 capital structure petition (Issue 2)?

3. Require the following in GMG's 2019 capital structure fling:

   a. a plan that would be expected to result in a 36.50 percent equity ratio by December 31, 2019, assuming normal weather, or an explanation why such an increase is not possible; and

   b. a step-increase in GMG's equity ratio floor from 33.00 percent to 34.0 percent beginning March 31, 2020, or an explanation why such an increase is not possible.

4. Other action by the Commission.