

June 15, 2018

Daniel P. Wolf
Executive Secretary
Minnesota Public Utilities Commission
121 7th Place East, Suite 350
St. Paul, Minnesota 55101

RE: **Comments of the Minnesota Department of Commerce, Division of Energy Resources**
Docket No. E017/S-18-313

Dear Mr. Wolf:

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

Petition of Otter Tail Power Company for Approval of 2018 Capital Structure and Permission to Issue Securities.

The petition was filed on May 1, 2018 by:

Kevin Moug
Treasurer
Otter Tail Power Company
215 South Cascade Street
Fergus Falls, Minnesota 56538.

The Department recommends **approval with additional reporting requirements** and is available to respond to any questions the Minnesota Public Utilities Commission may have.

Sincerely,

/s/ STEPHEN COLLINS
Rates Analyst

SC/lt
Attachment



Before the Minnesota Public Utilities Commission

Comments of the Minnesota Department of Commerce Division of Energy Resources

Docket No. E017/S-18-313

I. INTRODUCTION

On May 1, 2018, Otter Tail Power Company (OTP or the Company) filed its 2018 capital-structure petition. The petition requests that the Minnesota Public Utilities Commission (Commission):

- Approve a common-equity range of 47.9% to 58.5%, not to be exceeded for more than 60 days without Commission approval;
- Approve a short-term debt range up to 15%, not to be exceeded for more than 60 days without Commission approval;
- Approve a total maximum capitalization of \$1,204,416,000, not to be exceeded for more than 60 days without Commission approval;
- Continue to vary Minnesota Rules 7825.1000, subpart 6, to allow OTP to treat borrowings under its multi-year credit agreement as short-term debt for approved capital-structure purposes;
- Within the approved capital structure, allow OTP to issue debt and receive equity contributions from its parent company, Otter Tail Corporation; and
- Make the above approvals effective until the Commission issues its next capital structure Order.

OTP's expected capital structure for the end of this year is shown in Table 1 on the following page, whereas the capital structure ranges for which the Company is requesting approval (specified in the first two bullet points above) are shown in Table 2.

Table 1: OTP's Expected Capital Structure at the End of 2018

	Percent of Capitalization	Amount (millions)
Common Equity	53.2%	\$582
Short-Term Debt	0.0%	\$0
Long-Term Debt	46.8%	\$512
Total	100.0%	\$1,095

Table 2: OTP's Requested Capitalization Parameters

	Min	Max
Common Equity	47.9%	58.5%
Short-Term Debt	0.0%	15.0%
Long-Term Debt ¹	26.5%	52.1%

OTP intends to use the proceeds from security issuances over the 2018 capital structure period to help finance \$95 million in capital expenditures. About half of the expected capital expenditures are for transmission projects. The remainder of the expenditures are for generation, distribution, routine replacements, and customer information system upgrades.

II. DEPARTMENT ANALYSIS

A. BACKGROUND

OTP is a Minnesota Corporation with about 61,000 retail electricity customers in Minnesota.² OTP is a wholly owned subsidiary of Otter Tail Corporation, a holding company that also owns manufacturing and industrial-products operating companies. As a wholly owned subsidiary, OTP has its own capital structure and issues its own debt securities, but does not issue equity securities and instead receives equity contributions from Otter Tail Corporation. OTP currently maintains a long-term issuer credit rating of BBB from Standard & Poor's (S&P), one level above the investment-grade minimum of BBB-.³

¹ The minimum and maximum parameters for long-term debt are implied by OTP's requested parameters for common equity and short-term debt. That is, the minimum percentage for long-term debt is 1 minus the sum of the maximums for common equity and short-term debt ($1 - 58.5\% - 15.0\% = 26.5\%$), and the maximum percentage for long-term debt is 1 minus the sum of the minimums for common equity and short-term debt ($1 - 47.9\% - 0.0\% = 52.1\%$).

² OTP also has some municipal customers and about 70,000 retail customers in the Dakotas.

³ Otter Tail Corporation's long-term issuer rating from S&P is also BBB.

To issue securities, OTP needs approval under Minnesota Statutes section 216B.49 and approval of its capital structure per Minnesota Rules 7825.1100. Because OTP intends to issue securities during the 2018 capital-structure period, OTP has submitted a petition requesting both authorization to issue securities and approval of its 2018 capital structure. The Commission approved OTP's most recent capital structure and security issuances in an Order issued on September 1, 2017 in Docket No. E017/S-17-337, with the capital structure effective until the Commission issues its Order regarding OTP's 2018 capital structure.

B. PETITION COMPLETENESS

OTP's capital-structure/security-issuance filings must comply with a multitude of reporting requirements from Minnesota Administrative Rules and prior Commission Orders, summarized in Attachment 1 to these comments. The Department has reviewed OTP's petition and concludes that it complies with all applicable reporting requirements.

C. COMMON-EQUITY RATIO

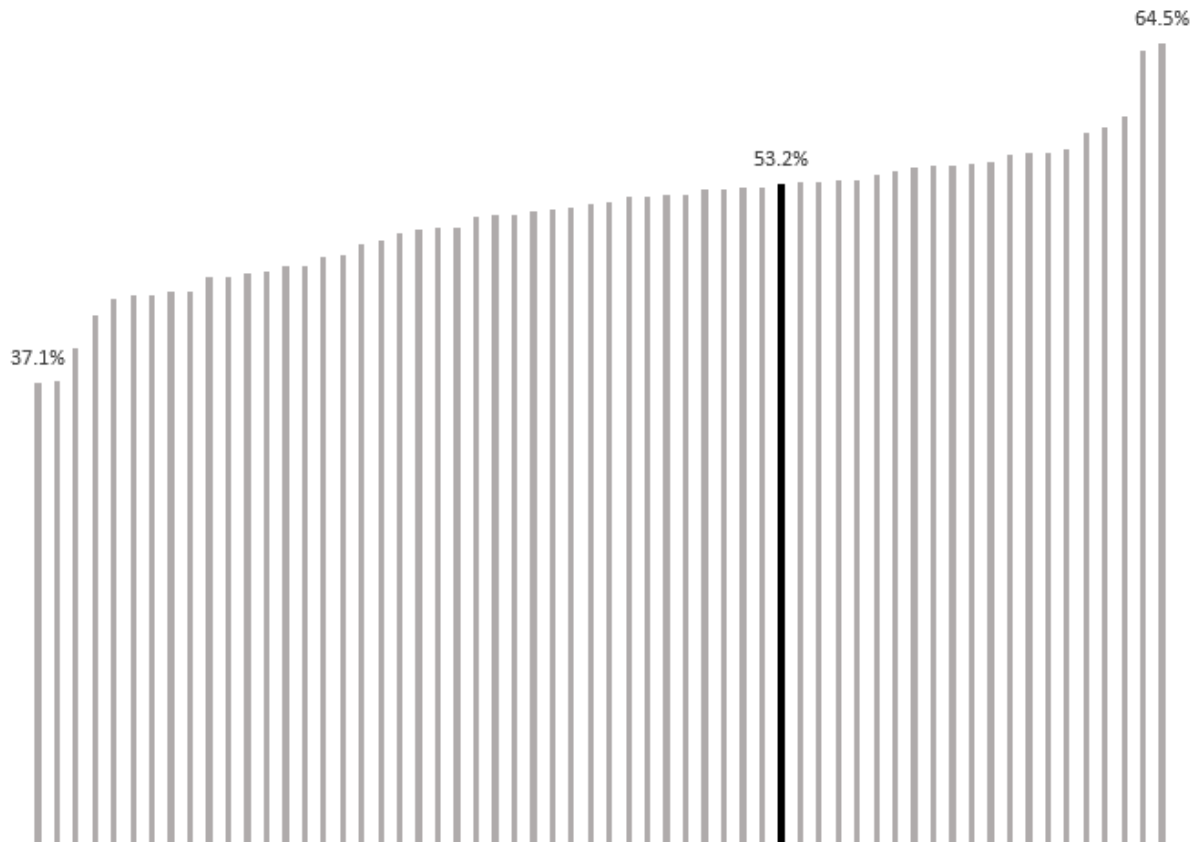
OTP's requested common-equity range of 47.9% to 58.5% is based on a midpoint of 53.2%, with 58.5% being one-tenth of the midpoint (5.32%) higher, and 47.9% being one-tenth lower. The requested range is 0.5% higher than the range approved for OTP's 2017 capital structure of 47.4% to 58.0%, which applied the same procedure to a midpoint of 52.7%. OTP has also requested that it be able to exceed the approved range for up to 60 days, and more than 60 days with prior Commission approval.

The Commission has historically authorized OTP to use a one-tenth range around a common-equity midpoint and a 60-day grace period, including for the 2017 capital structure currently in place. Given this history and the lack of adverse outcomes in recent years, the Department believes that these practices have worked well to allow the Company sufficient financing flexibility, keep the Company on sound financial footing, and maintain needed oversight for the Commission. The Department therefore concludes that continued adoption of these practices is reasonable and recommends that OTP's request to continue the practices be approved.

The 53.2% midpoint requested by OTP is the Company's projected actual common-equity ratio at the end of 2018, as shown in Attachment No. 1 to the Company's petition. As stated earlier, OTP's requested midpoint is 0.5% higher than the midpoint approved for the 2017 capital structure. As over the past year OTP has avoided financial distress and maintained an investment-grade credit rating, OTP's proposed midpoint does not appear too low as to unduly risk financial distress or harm OTP's ability to access capital on reasonable terms. OTP's proposed midpoint also does not appear too high as to insufficiently take advantage of the benefits of debt financing, as it is within the middle range of equity ratios of other investment-

grade U.S. electric utilities, as shown in the figure below. Therefore, the Department recommends approval of OTP's requested equity-ratio midpoint.

Figure 1: OTP's Requested Equity-Ratio Midpoint versus Equity Ratios of Other Invest-Grade U.S. Electric Utilities



Data Source: S&P Global Market Intelligence

D. SHORT-TERM DEBT RATIO

In addition to requesting a common-equity range of 47.9% to 58.5%, OTP has requested to issue up to 15% of its total capitalization as short-term debt.

The Commission has over recent years approved a 15% cap on short-term debt for OTP and other utilities. This cap has worked well to provide OTP with adequate short-term financial flexibility while not unduly risking harm to ratepayers. Particularly as at the end of 2017 OTP has maintained an actual short-term debt ratio of 10.4%, which the Company expects to pay off

by the end of 2018, and OTP continues to be rated as investment grade, the Department sees no reason for a change in course and therefore recommends that the Commission continue to approve the 15% cap on short-term debt.

E. MAXIMUM TOTAL CAPITALIZATION

OTP's requested maximum total capitalization of \$1,204,416,000 is based on an expected capitalization of \$1,094,924,000 plus an additional one-tenth (\$109,492,400) cushion. The requested maximum is slightly higher than the \$1,178,024,000 amount approved for the 2017 capital structure, which was based on a one-tenth cushion over an expected capitalization of \$1,070,931,000.

Allowing OTP a one-tenth cushion above its expected capitalization and a 60-day grace period has been approved for previous OTP capital structure petitions. Given this history and the lack of adverse outcomes in recent years, the Department concludes that these practices have worked well historically to allow the Company sufficient financing flexibility, keep the Company on sound financial footing, and maintain needed oversight for the Commission. The Department therefore recommends that the Commission approve the Company's request for a one-tenth of a percent contingency above an expected total capitalization of \$1,094,924,000 and a 60-day grace period for expenditures above \$1,204,416,000.

F. CONTINUED VARIANCE OF MINNESOTA RULES 7825.1000, SUBPART 6

OTP requests that the Commission continue to vary Minnesota Rules 7825.1000, subpart 6, to allow OTP to treat borrowings under its multi-year credit agreement as short-term debt for approved capital structure purposes. Because Minn. Rules part 7825.1000, subpart 6, defines short-term securities as those with a date of maturity of no more than one year, to classify multi-year credit agreements as short-term debt, OTP needs the Commission to make the requested variance.

To vary its rules, the Commission must determine, per Minn. Rules 7829.3200, subp. 1, that the variance satisfies three requirements:

- A. Enforcement of the rule would impose an excessive burden upon the applicant or others affected by the rule,
- B. Granting the variance would not adversely affect the public interest, and
- C. Granting the variance would not conflict with standards imposed by law.

The Department agrees with OTP that the Company's requested variance satisfies the three requirements. OTP's current multi-year credit agreement resembles traditional short-term

debt instruments and classifying multi-year credit agreements as long-term debt could cause credit-rating agencies to react unfavorably, thus imposing an excessive burden on OTP and hurting ratepayers. In addition, classifying multi-year credit agreements as short-term debt would not conflict with any standards imposed by law. Therefore, the Department recommends that the Commission continue to vary Minn. Rules 7825.1000, subp. 6, and allow OTP to treat borrowing under multi-year credit agreements as short-term debt for approved capital structure purposes.

G. SECURITY ISSUANCE

OTP requests that the Commission allow the Company to issue debt securities and receive equity contributions from Otter Tail Corporation, as long as the Company stays within the approved capital structure.

As specified in Minnesota Statutes section 216B.49, subdivision 4, to approve a security issuance, the Commission must find that the issuance is in the public interest, which requires that the types of capital issued (common equity, short-term debt, long-term debt, etc.) bear a reasonable proportion to each other and to the value of the property, and that the issuance not harm ratepayers. The Department concludes that OTP's request satisfies these criteria because the approved capital structure will be in the public interest and any increase in rates stemming from an issuance will require a public interest finding. Therefore, the Department recommends that the Commission approve OTP's request to issue securities within the approved capital structure.

A. DURATION OF APPROVAL

OTP states that it expects the "Authorization Period" of the 2018 Capital Structure will last until the middle of 2019, if approved. Consistent with this expectation and the date of this year's filing, the Department recommends that the Commission require OTP to make its 2019 capital structure filing on May 1, 2019 and make the approval of the 2018 capital structure effective until the Commission issues its Order on the 2019 capital structure.

B. ADDITIONAL PERMANENT REPORTING REQUIREMENTS

Certain filing requirements have been issued anew in each annual capital structure Order. To avoid needless repetition, the Department believes it is preferable to make these requirements a permanent part of reporting for OTP's annual capital structure filings. Therefore, the Department recommends that the Commission require OTP to provide the following reporting information in all future capital structure filings.

- In all future capital structure filings, OTP must provide a schedule comparing its actual capital investments in the past year with the capital investments projected by OTP in the preceding year's capital structure filing.
- In all future capital structure filings, OTP must provide the Company's investment plan for at least the next five years.
- in all future capital structure filings, OTP must report on its use of its multi-year credit facility, including how often the facility was used, the amount involved in any usage, rates and financing costs, and the intended uses of the financing.

In addition, the Department recommends that the Commission require OTP to provide the following information in all future annual capital structure filings:

- To the extent practicable, evidence to demonstrate that any bond issuances since the date of OTP's last annual capital structure filing were cost competitive, with the analysis including, at a minimum, a detailed comparison of OTP's bond issuances to all other utility bond issuances over the same period.

The Department believes that obtaining this information is in the public interest because it helps ensure that OTP is minimizing the cost of serving customers.

III. DEPARTMENT RECOMMENDATION

The Department recommends that the Commission take the actions requested by OTP, specifically:

- Approve a common-equity range of 47.9% to 58.5%, not to be exceeded for more than 60 days without Commission approval;
- Approve a short-term debt range up to 15%, not to be exceeded for more than 60 days without Commission approval;
- Approve a total maximum capitalization of \$1,204,416,000, not to be exceeded for more than 60 days without Commission approval;
- Continue to vary Minnesota Rules 7825.1000, subpart 6, to allow OTP to treat borrowings under its multi-year credit agreement as short-term debt for approved capital-structure purposes;
- Within the approved capital structure, allow OTP to issue debt and receive equity contributions from its parent company, Otter Tail Corporation; and

- Make the above approvals effective until the Commission issues its next capital structure Order.

The Department also recommends that the Commission require OTP to provide the following reporting information in all future capital structure filings.

- In all future capital structure filings, OTP must provide a schedule comparing its actual capital investments in the past year with the capital investments projected by OTP in the preceding year's capital structure filing.
- In all future capital structure filings, OTP must provide the Company's investment plan for at least the next five years.
- in all future capital structure filings, OTP must report on its use of its multi-year credit facility, including how often the facility was used, the amount involved in any usage, rates and financing costs, and the intended uses of the financing.
- To the extent practicable, evidence to demonstrate that any bond issuances since the date of OTP's last annual capital structure filing were cost competitive, with the analysis including, at a minimum, a detailed comparison of OTP's bond issuances to all other utility bond issuances over the same period.

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Source	Reporting Requirement	Location of Information in Petition
Minn. Rules 7825.1400	A. A descriptive title.	page 4
	B. A table of contents.	pages i-iii
	C. The exact name of the petitioner and address of its principal business office.	page 4
	D. Name, address, and telephone number of the person authorized to receive notices and communications with respect to the petition.	page 4
	E. A verified statement by a responsible officer of the petitioner attesting to the accuracy and completeness of the enclosed information.	Attachment 2
	F. The purpose for which the securities are to be issued.	pages 5-6, Attachment 10b
	G. Copies of resolutions by the directors authorizing the petition for the issue or assumption of liability in respect to which the petition is made; and if approval of stockholders has been obtained, copies of the resolution of the stockholders shall be furnished.	Attachment 3
	H. A statement as to whether, at the time of filing of the petition, the petitioner knows of any person who is an "affiliated interest" within the meaning of Minnesota Statutes, section 216B.48, subdivision 1, who has received or is entitled to receive a fee for services in connection with the negotiations or consummation of the issuance of the securities, or for services in securing underwriters, sellers, or purchasers of the securities.	page 7
	I. A signed copy of the opinion of counsel in respect to the legality of the issue or assumption of liability.	Attachment 4
	J. A balance sheet dated no earlier than six months prior to the date of the petition together with an income statement and statement of changes in financial position covering the 12 months then ended. When the petitions include long-term securities, such statements shall show the effects of the issuance on such balance sheet and income statement.	Attachment 5
	K. A description of the security or securities to be issued.	pages 8-13
	L. An estimate of the interest or dividend cost per \$100 principal amount, except in the case of common stock, and a description of any anticipated terms or indenture provisions.	page 13
	M. If the petitioner is a corporation, a copy of its current articles of incorporation certified by the secretary of state of incorporation. If the current articles have already been filed, the petitioner need only make specific reference to such filings.	page 13
	N(1). The amount and kinds of stock authorized by articles of incorporation and amount outstanding.	Attachment 7
	N(2). The terms of preference of preferred stock, whether cumulative or participating, or on dividends or assets, or otherwise.	Attachment 7
	N(3). A brief description of each security agreement, mortgage, and deed of trust upon petitioner's property, showing date of execution, debtor, and secured party, mortgagor and mortgagee and trustor and beneficiary, amount of indebtedness authorized to be secured thereby, and amount of indebtedness actually secured, together with any sinking fund provision.	page 14
	N(4). The amount of bonds authorized and issued that exceed one percent of total debt giving the name of the public utility which issued same, describing each class separately, and giving the date of issue, par value, rate of interest, date of maturity, and how secured, together with the amount of interest paid thereon during the last fiscal year.	Attachment 6
	N(5). Each note outstanding with a maturity of more than one year and which exceeds one percent of total debt, giving the date of issue, the amount, the date of maturity, the rate of interest, in whose favor, together with the amount of interest paid thereon during the last fiscal year.	Attachment 6
	N(6). Other indebtedness with a maturity of more than one year, by class, together with the amount of interest paid thereon during the last fiscal year.	Attachment 6
N(7). The rate and amount of dividends paid during the five previous fiscal years.	Attachment 8	
O. A statement of the manner in which such securities will be issued; and if invitations for sealed written proposals (competitive bidding) are not anticipated, an explanation of the decision not to invite such proposals shall be submitted.	pages 14-16	
P. A copy of each plan, offer, or agreement for the reorganization or readjustment of indebtedness or capitalization or for the retirement or exchange of securities.	page 16	
R. Such additional information that the staff or commission may require in a particular case.	see requirements on next page	
S. If a filing requirement does not apply, it shall be so stated with an explanation why it does not apply.	page 17	

Source	Reporting Requirement	Location of Information in Petition
2017-09-01 Order in E017/S-17-337	Report on OTP's use of multi-year credit facilities, including how often they are used, the amount involved, rates and financing costs, and the intended uses of the financing.	Attachment 11
2017-09-01 Order in E017/S-17-337	A schedule comparing OTP's actual capital investments in the past year with the capital investments projected by OTP in its previous capital structure filing.	
2017-09-01 Order in E017/S-17-337	OTP's investment plan for at least the next five years.	
2009-05-12 Order in E,G999/CI-08-1416	An exhibit providing a general projection of capital needs, projected expenditures, anticipated sources, and anticipated timing, with the understanding that such exhibit is not intended to require dollar-for-dollar on the uses identified in the exhibit or to limit issuances to project-specific financing. The exhibit need not list short-term, recurring security issuances.	Attachments 10a, 10b, 10c
	A report of actual issuances and uses of the funds from the prior year. The report will be for information purposes only and need not cover short-term, recurring security issuances.	
	Within 20 days of each non-recurring security issuance, an after-the-fact report, filed for information purposes only, providing the following information: 1) the type of security issued; 2) the total amount issued; 3) the purpose of the issuance; 4) the issuance cost associated with the security issuance; and 5) the total cost of the security issuance, including details such as interest rate or cost per share of common equity issued.	informational filings in docket 17-337
Minn. Rules 7825.1300	A cash-flow statement by month showing the most recent available 21 months actual data and forecasted data to the end of the period encompassed by the petition, filed on forms prescribed by the commission, with a descriptive summary of the assumptions made in the developments in the cash-flow statement (this requirement only applies to petitions to issue short-term securities)	Attachments 9 & 10
Minn. Rules 7825.1500	A. A copy of the final registration statement, if any, and financial exhibits made a part thereof, filed with the Securities and Exchange Commission in accordance with the Securities Act of 1933.	Supplemental Filing
	B. If an invitation for sealed written public proposals for the purchase or underwriting of such securities has been made, a summary of the terms of the proposals received, including the name of each bidder or representative of a bidding group, the interest or dividend rate specified, where applicable, the price to be paid the issuer per unit or \$100 principal amount, the cost of money to the issuer, except in the case of common stock, the name of the successful bidder, and the successful bidder's initial public offering price and the resulting yield to the public, except in the case of common stock.	Supplemental Filing