COMMERCE DEPARTMENT

December 21, 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. E,G002/S-20-768

Dear Mr. Seuffert:

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

Petition of Northern States Power Company for Approval of Its 2021 Capital Structure.

The Petition was filed on October 5, 2020 by:

Patricia L. Martin
Assistant Treasurer
Xcel Energy Services Inc.
414 Nicollet Mall (401-4th Floor)
Minneapolis, Minnesota 55401.

The Department recommends that the Minnesota Public Utilities Commission (Commission) **approve the petition with one modification**. 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

MN COMMERCE DEPARTMENT

Before the Minnesota Public Utilities Commission

Comments of the Minnesota Department of Commerce
Division of Energy Resources

Docket No. E,G002/S-20-768

I. INTRODUCTION

On October 5, 2020, Northern States Power Company doing business as Xcel Energy (Xcel[1] or the Company) filed a petition requesting that the Minnesota Public Utilities Commission (Commission) approve the Company's 2021 capital structure. Specifically, Xcel has requested authorization to:

- Maintain an equity ratio of 47.16% to 57.64% -- derived from a projected equity ratio of 52.4% plus or minus a contingency band of 10 percent of the midpoint (+ or – 5.24%);
- Issue short-term debt up to 15% of total capitalization;
- Set a maximum capitalization of $13.947 billion – derived from Xcel's projected 2021 base capitalization of $13.301 billion plus a 4.86% contingency of $646 million;
- Continue varying Minnesota Rules 7825.1000, subpart 6 to allow Xcel to treat borrowing under multi-year credit agreements as short-term debt for approved capital structure purposes;
- Use risk management instruments that qualify for hedge accounting treatment; and
- Issue securities provided that Xcel does not exceed the limits of the approved equity ratio, maximum short-term debt ratio, or maximum capitalization for more than 60 days *without notifying the Commission*.[2]

In effect, these requests would allow Xcel to reach up to $7.370 billion ([1 – 47.16%] * $13.947 billion) of debt outstanding.

Finally, Xcel requests that the Commission approve the petition by February 1, 2021, effective until the Commission issues a 2022 capital structure Order.

---

[1] Since Xcel is both an electric and gas utility, the capital structure petition pertains to Xcel's combined electric and gas operations (in addition to Xcel's wholly owned subsidiaries United Power & Land Company and NSP Nuclear Corporation).

[2] Xcel also specifically requests authorization to (a) enter into and use multi-year credit agreements and issue associated notes, (b) issue long-term debt, and (c) enter into financings to replace outstanding long-term debt instruments with less expensive securities after considering the debt issuance expenses and amortization of redemption premiums and expenses, and to enter into tax-exempt financings if funds are available for construction programs. These requests are redundant with the request for authorization to issue securities. However, the Department appreciates Xcel specifying its planned security issuances.

Xcel's planned investments for 2020 and next five years are shown below, taken from Attachment N to Xcel's petition. Planned capital expenditures for the next five years total about $8 billion, averaging around $1.6 billion per year. For 2021, the largest uses of capital will be electric distribution upgrades and wind farms. Based on Xcel's categorization, the Department understands that around 90% of Xcel's planned capital expenditures are for electric operations, with only about 10% for gas.

Table 1: Xcel's Planned Investments

Category	Forecast as of July 2020											
	2020		2021		2022		2023		2024		2025	
	$M	% Total	$M	% Total	$M	% Total	$M	% Total	$M	% Total	$M	% Total
Energy Supply	**1,233**	59.0%	**406**	26.1%	**124**	8.1%	**123**	7.6%	**268**	16.7%	**546**	29.8%
...Wind	**1,147**	54.9%	**296**	19.1%	**-7**	-0.5%	**0**	0.0%	**0**	0.0%	**0**	0.0%
...Black Dog Site Rem.	**4**	0.2%	**7**	0.5%	**6**	0.4%	**5**	0.3%	**5**	0.3%	**5**	0.3%
...Other Energy Supply	**82**	3.9%	**101**	6.5%	**103**	6.7%	**68**	4.2%	**75**	4.7%	**110**	6.0%
…BLL Black Start Conv.	**0**	0.0%	**0**	0.0%	**0**	0.0%	**9**	0.6%	**22**	1.4%	**16**	0.9%
…Sherco CC	**0**	0.0%	**2**	0.1%	**22**	1.4%	**41**	2.5%	**166**	10.4%	**415**	22.6%
Nuclear	**145**	6.9%	**223**	14.4%	**213**	13.9%	**229**	14.1%	**181**	11.3%	**215**	11.7%
...Nuclear Fuel	**55**	2.6%	**104**	6.7%	**87**	5.7%	**105**	6.5%	**84**	5.2%	**116**	6.3%
...Other Nuclear	**90**	4.3%	**119**	7.7%	**126**	8.2%	**124**	7.7%	**97**	6.1%	**99**	5.4%
Transmission	**143**	6.8%	**234**	15.1%	**304**	19.9%	**318**	19.6%	**306**	19.1%	**305**	16.6%
...Huntley Wilmarth Line	**39**	1.9%	**30**	1.9%	**4**	0.3%	**0**	0.0%	**0**	0.0%	**0**	0.0%
...Sioux Falls N. 115 kV Loop	**1**	0.0%	**0**	0.0%	**0**	0.0%	**0**	0.0%	**0**	0.0%	**0**	0.0%
...Other Transmission	**103**	4.9%	**204**	13.1%	**300**	19.6%	**318**	19.6%	**306**	19.1%	**305**	16.6%
"Other"	**180**	8.6%	**164**	10.6%	**213**	13.9%	**223**	13.8%	**160**	10.0%	**126**	6.9%
Distribution	**390**	18.7%	**526**	33.9%	**677**	44.2%	**727**	44.9%	**687**	42.9%	**641**	35.0%
...Electric	**279**	13.3%	**349**	22.5%	**524**	34.2%	**550**	34.0%	**503**	31.4%	**468**	25.5%
...Gas	**111**	5.3%	**177**	11.4%	**153**	10.0%	**177**	10.9%	**184**	11.5%	**173**	9.4%
Total	**2,091**	100.0%	**1,553**	100.0%	**1,531**	100.0%	**1,620**	100.0%	**1,602**	100.0%	**1,833**	100.0%

According to Attachment H of Xcel's petition, Xcel plans to fund the $1.553 billion of 2021 investments using $125 million of equity infusions from its parent company Xcel Energy Inc. (XEI), $1.0 billion from short-term debt and internal funds, and $400 million in long-term debt which Xcel intends to issue the in the second quarter of 2021. For context, Xcel issued $600 million in long-term debt in 2019 and $700 million in long-term debt in 2020.

The Minnesota Department of Commerce, Division of Energy Resources (Department) analyzes Xcel's petition below.

II. DEPARTMENT ANALYSIS

A. REPORTING REQUIRMENTS

Minnesota Administrative Rules and prior Commission Orders establish certain reporting requirements, as detailed in Attachment DOC-1. The Department concludes that Xcel has complied with these reporting requirements.

B. ONGOING REQUIREMENTS

Xcel must also comply with a number of ongoing requirements, a shown in the table below.

Table 2: Ongoing Requirements

Source	**Requirement**
2004-07-09 Order in E,G002/AI-04-100	Xcel must not use the Utility Money Pool if it can borrow directly from a bank or other financial institution at a lower rate.
	Xcel can lend to the Utility Money Pool only if the returns on investment are equal to or greater than returns Xcel could have received elsewhere.
2003-01-13 Order in E,G002/S-02-1907	File capital structures annually.
	Encumber no utility property in Minnesota for purposes other than operating the utility, and use no Minnesota property for non-utility purposes.
	Make no inter-company loans to Xcel Energy Inc.

The Department concludes that Xcel continues to comply with these ongoing requirements.

C. CAPITAL STRUCTURE

1. Applicable Statutes

Minnesota Statutes section 216B.49, subdivision 3 states:

> It is unlawful for any public utility organized under the laws of this state to offer or sell any security … unless the security issuance of the public utility is first approved by the commission, either as an individual issuance or as one of multiple possible issuances approved in the course of a periodic proceeding reviewing the utility's proposed sources and uses of capital funds. Approval by the commission must be by formal written order.

Further, Minnesota Statutes section 216B.49, subdivision 4 states in part that:

> If the commission shall find that the proposed security issuance is reasonable and proper and in the public interest and will not be detrimental to the interests of the consumers and patrons affected thereby, the commission shall by written order grant its permission for the proposed public financing.

2. *Current Capital Structure*

The Commission approved Xcel's most recent capital structure in an Order issued April 10, 2020 in Docket No. E,G002/S-19-662 (2019 Capital Structure Order), approving the following:

- Maintain an equity ratio of 47.07% to 57.53% -- derived from an midpoint of 52.3% plus or minus a contingency band of 10 percent of the midpoint (+ or – 5.23%);
- Issue short-term debt up to 15% of total capitalization;
- Set a maximum capitalization of $13.200 billion – derived from Xcel's projected base capitalization of $12.604 billion plus a 4.73% contingency of $0.596 billion;
- Continue varying Minn. Rules 7825.1000, subp. 6 to allow Xcel to treat borrowing under multi-year credit agreements as short-term debt for approved capital structure purposes;
- Use risk management instruments that qualify for hedge accounting treatment; and
- Issue securities provided that Xcel does not exceed the limits of the approved equity ratio, maximum short-term debt ratio, or maximum capitalization for more than 60 days *without the Commission's preapproval*.

In addition, the Commission made the 2020 capital structure effective until the Commission issues a 2021 capital structure Order.

The maximum debt allowed by the 2019 Capital Structure Order was $6.987 billion ([1 – 47.07%] * $13.200 billion).

3. *Proposed Capital Structure*

Xcel's request for this year is the same as last year's except for:

- The requested equity ratio range is based on a slightly higher midpoint – 52.40%% instead of last year's 52.30% -- resulting in a slightly higher and wider requested range of 47.16% to 57.64% versus 47.07% to 57.53% last year;
- The requested maximum capitalization is 5.66% higher – from $13.200 billion last year to $13.947 billion this year; and
- Xcel requests the ability to exceed the capital structure contingency ranges for more than 60 days merely by notifying the Commission instead of gaining preapproval as currently required.

a.) *Short-Term Debt, 60-Day Window, 7825.1000 Variance, and Risk Management Instruments*

The Department concludes that it is reasonable to maintain the long-standing policies for Xcel regarding issuing short-term debt up to 15% of total capitalization, the requested variance of 7825.1000 subpart 6, use of risk management instruments that qualify for hedge accounting treatment, and the 60-day window.

i. Short-Term Debt

The 15% cap on short-term debt has been in effect for over a decade and has historically worked to serve its purpose of providing Xcel with adequate short-term financial flexibility while not unduly risking harm to ratepayers.

ii. 60-Day Window

The Department notes that the Commission's long-standing 60-day window policy allows the Company sufficient flexibility to manage short-term aberrations while not allowing deviations from approved capital structure parameters for an undue amount of time. The Department recommends that the Commission continue to require preapproval to go outside the capital structure for more than 60 days. Otherwise, Xcel would be able to go outside the bounds of its allowed capital structure for an indefinite amount of time without Commission approval.

iii. Variance to 7825.1000 Subpart 6

Regarding the requested variance, Minn. R. 7825.1000, subp. 6 defines short-term securities as:

> any unsecured security with a date of maturity of no more than one year from the date of issuance; and containing no provisions for automatic renewal or "roll over" at the option of either the obligee or obligor.

In order to classify direct borrowings under its multi-year credit agreement as short-term debt, the Commission would have to vary this rule for Xcel. Per Minn. R. 7829.3200, subp. 1, the Commission can only grant the variance if the following three requirements are met:

1. enforcement of the rule would impose an excessive burden upon the applicant or others affected by the rule,
2. granting the variance would not adversely affect the public interest, and
3. granting the variance would not conflict with standards imposed by law.

The Department agrees with the Company that these requirements are met. Xcel's current multi-year credit agreement resembles traditional short-term debt instruments and classifying multi-year credit agreements as long-debt could cause credit-rating agencies to react unfavorably, thus imposing an excessive burden on Xcel 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 Xcel to treat borrowing under multi-year credit agreements as short-term debt. The Department notes that the Commission has made the same variance and allowance for all approvals of Xcel's capital structure since 2005.

iv. Use of risk management instruments that qualify for hedge accounting treatment

Xcel requests that the Commission continue to allow the Company to use risk management instruments that qualify for hedge accounting treatment under Accounting Standard Codification No. 815, such as interest rate swaps, in compliance with the policies of Xcel's parent company, and with required officer approvals. It appears that Xcel would primarily or exclusively use such instruments to hedge against the risk of changing interest rates.

The Department agrees with Xcel that risk-management instruments such as interest rate swaps can benefit ratepayers as long as Xcel follows prudent practices in its usage of such instruments and allows the Commission sufficient oversight. Given the oversight mechanism provided by the reporting requirements shown in Attachment DOC-1, the Department concludes that the Commission has sufficient oversight of the Company's risk management instruments. Therefore, the Department recommends that the Commission approve the Company's request.

b.) Equity Ratio Range and Maximum Capitalization

Utilities' capital structures should be low enough to take advantage of debt's lower cost of financing (relative to equity), but not so high as to unduly risk financial distress. Gas and electric utilities typically use around 50% equity, which is consistent with Xcel's proposed equity ratio range.

However, it is important to understand the maximum level of debt that Xcel could issue when combining its proposed equity ratio range with its proposed maximum capitalization, and then compare that maximum debt level to the Company's debt-servicing ability.

In some recent capital-structure dockets, the Department has used earnings before interest, taxes, depreciation, and amortization (EBITDA, calculated as operating income plus depreciation and amortization) to measure a utility's debt-servicing ability. The Department's main reason for using EBITDA was that net debt (debt minus cash and cash equivalents) divided by EBITDA is a very common measure of financial leverage and in some ways provides a standardized measure of leverage.

However, upon further consideration, the Department has concluded that, for the purposes of its capital-structure analyses, earnings before interest and taxes (EBIT, calculated as operating income[3]) represents a more accurate measure of debt-servicing ability because depreciation and amortization

[3] An alternative way to define EBIT is net income with interest and taxes added back. However, due to the ability of unusual non-operating costs or gains to affect net income, the Department's methodology more accurately represents normalized ability to pay back debt.

represent real costs that a utility must incur. The Department reviews Xcel's ratio of debt to EBIT below.[4]

For a utility, the ratio of debt to EBIT indicates the years needed to pay back its current level of debt principal, assuming constant EBIT. In 2019 and 2018, Xcel generated EBIT of $786.9 and $716.5,[5] respectively. Xcel's total debt for the same years was $5.551 billion and $5.087 billion respectively.[6] The debt-EBIT ratio for both years was 7.1.

At the $7.370 billion maximum debt level implied by Xcel's proposed 2021 capital structure and assuming normalized EBIT grows by 7% per year, Xcel's 2021 debt-EBIT ratio would reach 8.2. Given that this level is only moderately above Xcel's 2019 and 2018 debt-EBIT ratio and Xcel appears to be in a very healthy financial position, the Department views the implied maximum debt-EBIT ratio as reasonable. In addition, as noted above, Xcel's proposed equity ratio is nearly identical to last year's and consistent with the typical 50% ratio used for gas and electric utilities. For these reasons, the Department supports Xcel's proposed equity ratio range and maximum capitalization.

III. RECOMMENDATION

The Department recommends that the Commission approve the petition modified to continue requiring Xcel to gain preapproval to deviate from the approved capital structure for more than 60 days (instead of granting Xcel's request to deviate from the approved capital structure for more than 60 days merely by notifying the Commission).

---

[4] Given Xcel is a wholly owned subsidiary of XEI and can receive cash (equity) infusions from XEI at any time, its cash position is somewhat difficult to ascertain. Therefore, the Department uses debt/EBIT instead of net-debt/EBIT.

[5] Petition, Attachment I, Part 2, page 10 (operating income).

[6] Petition, Attachment I, Part 2, page 11 (sum of long-term debt, short-term debt, and current portion of long-term debt).