

June 5, 2020

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

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

Dear Mr. Seuffert:

Attached are the **PUBLIC** Response 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 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



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 or the Company). 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.

On April 20, 2020, the Minnesota Department of Commerce, Division of Energy Resources (Department) issued comments, which requested additional information from Minnesota Power.

On May 18, 2020, MP filed reply comments.

II. DEPARTMENT ANALYSIS

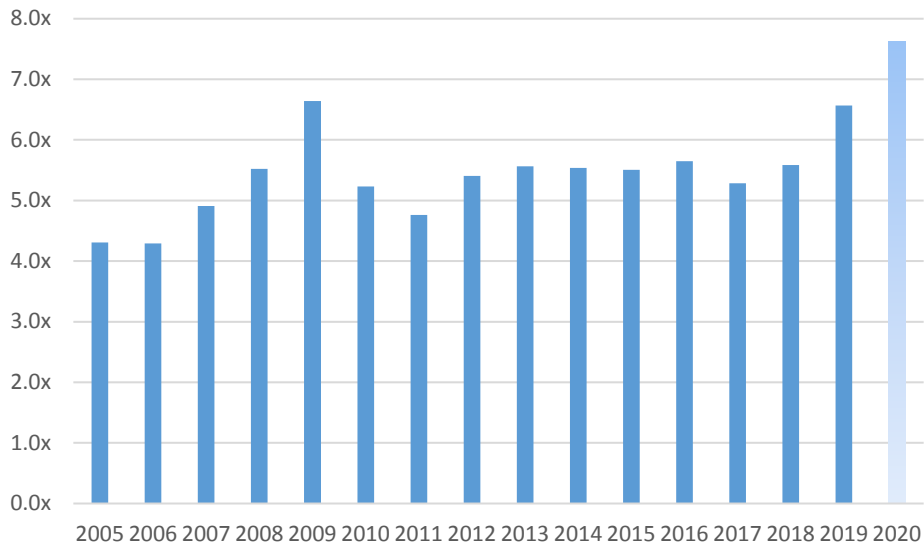
While the Department appreciates MP providing additional information and clarifications, MP’s reply comments do not address the Department’s core concern about the maximum level of debt used to

finance ALLETE’s non-regulated operations¹ and how this debt could potentially harm MP’s ratepayers, given that MP is a division of ALLETE. The Department elaborates below.

MP is requesting that ALLETE be allowed to issue debt up to \$2.9852 billion, the combination of the requested maximum capitalization of \$6.145 billion and maximum debt ratio of 48.52%. As shown in the Department’s initial comments, this level would allow ALLETE to increase its net-debt/EBITDA (earnings before interest, taxes, and depreciation²) to around 7.6x, or even higher if this year’s macroeconomic issues cause ALLETE’s EBITDA to decline. As Figure 1, below, shows, such an outcome would be far higher than normal, and even higher than the levels seen during the Great Recession in 2008-2009.

Figure 1: ALLETE’s Maximum Allowed Net-Debt/EBITDA

(2020 figure uses normalized EBITDA; may be higher if EBITDA is depressed this year due to macroeconomic issues)

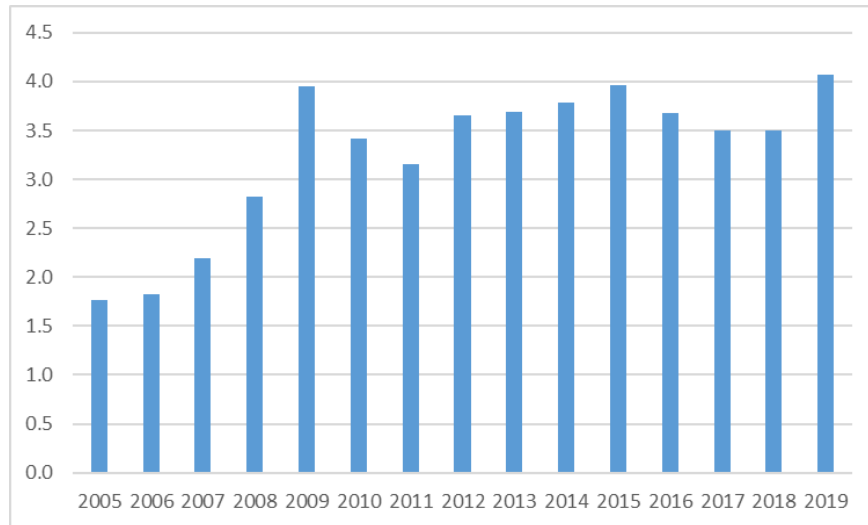


At the same time, ALLETE’s actual net-debt/EBITDA has remained elevated since the Great Recession. See Figure 2 below.

¹ Please see Attachment 1, which is nonpublic in its entirety, for further information about this issue. As the entire attachment is nonpublic, it is not included in the public version of these comments.

² As noted in the Department’s initial comments, the Department calculates EBITDA as operating income plus depreciation and amortization due to the accounting irregularities in net income. The outcome is a similar measure to cash from operations but with irregularities in cash smoothed out from year to year.

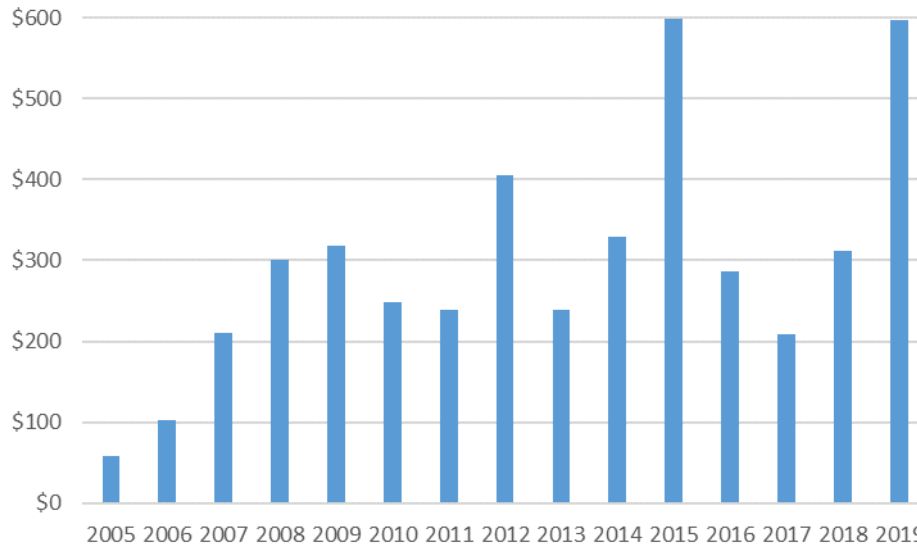
Figure 2: ALLETE Actual Net-Debt to EBITDA



Based on ALLETE’s borrowings in 2020 so far (\$140 million in long-term debt on March 26, 2020 and \$95 in short-term debt on April 8, 2020) and projections in their petition, the Department expects net debt to be higher this year whereas EBITDA may be lower. As a result, 2020 net-debt/EBITDA will likely be even higher than 2019’s 4.1x level, which already exceed the previous highs of 4.0x set in 2009 and 2015.

The Department is concerned that this ratio may continue to worsen as a result of ALLETE’s surging capital expenditures (capex), if too much of these expenditures are financed by debt. As shown in Figure 3, since 2005, ALLETE’s capex has increased significantly. For 2020, the Company’s petition included a projected [NONPUBLIC DATA] in capex, of which [NONPUBLIC DATA] was forecasted for non-regulated activities, an amount [NONPUBLIC DATA]. ALLETE’s petition indicates plans for similarly elevated levels of capex in 2021.

Figure 3: ALLETE Capex (millions)



While the Department takes no issue with ALLETE’s desire to pursue non-regulated lines of businesses *per se*, the Department is concerned that this pursuit could eventually increase the cost of capital for MP if too much debt is used to finance those activities, as MP is a division of ALLETE. Therefore, any issues that ALLETE encounters as a result of using debt to finance its nonregulated activities could eventually raise the cost of capital for MP or create problems for MP through any restructuring costs that would result of any ALLETE bankruptcy proceedings, both of which could increase rates.

MP’s reply comments state that the debt is needed to finance wind projects because “due to the nature and unique timing of tax equity financing, ALLETE needs the flexibility to finance the tax equity projects with debt through the construction phase, and then subsequently replace the debt with a tax equity investment once the project is placed in service.” MP’s statement implies that the increase in ALLETE’s leverage will go down at some point in the future. However, MP did not provide any data to support this assertion nor has MP attempted to quantify it, which would allow for an assessment of whether the maximum debt requested by MP is actually necessary and would not lead to a situation where ratepayers are seriously harmed. Further, MP declined over email to provide the Department with the tax equity financing agreements, which would allow the Department to verify MP’s claims and assess both the quantity and probability of any tax equity financing replacing debt on ALLETE’s balance sheet. MP did however state in an email that one of the two current ongoing wind projects does not yet have a binding tax equity agreement in place.

As noted earlier and as shown in Figure 1 above, MP’s requested level of maximum debt for ALLETE would result in a debt/EBITDA ratio of at least 7.6x, versus 6.6x last year and a range of 4.8-5.6x seen since 2009. MP has not shown why this level of debt would be necessary, nor has it shown how ALLETE could reach this level of debt while also protecting ratepayers and not raising its cost of capital.

To address this issue, the Department recommends that ALLETE be required to limit its maximum debt to last year's maximum of \$2,578, versus MP's requested \$2,982 million. For context, ALLETE had \$1,623 million of debt at the end of 2019, which increased to \$1,731 as of March 31, 2020 due to the debt issuances thus far in 2020 (cited above). At a \$2,578 maximum, ALLETE would still have the flexibility to increase debt by another 49%, or \$847 million. The Department expects that this level would leave ALLETE with more than enough flexibility and put much more reasonable limits on ALLETE's debt than the Company's requested \$2,982 million. With this modification, the Department would not object to MP's requested total capitalization and equity ratio range, as the modification would place a reasonable limit on debt.

III. RECOMMENDATION

The Department recommends that the Commission approve MP's petition, but limit debt to \$2,578 million.

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
Public Response Comments**

Docket No. E015/S-20-279

Dated this 5th day of **June 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 PI E Ste 350 Saint Paul, MN 55101 | Electronic Service | Yes | OFF_SL_20-279_S-20-279 |