minnesota power
AN ALLETE COMPANY

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May 18, 2020

VIA E-FILING
Will Seuffert
Executive Secretary
Minnesota Public Utilities Commission
121 7th Place East, Suite 350
St. Paul, MN 55101-2147

Re: In the Matter of the Petition of Minnesota Power Under Minnesota Statutes Section 216B.49 for Approval of its Capital Structure and Authorization to Issue Securities
Docket No. E015/S-20-279
REPLY COMMENTS

Dear Dr. Seuffert:

Minnesota Power submits these Reply Comments to the Minnesota Public Utilities Commission in response to the Department of Commerce – Division of Energy Resources Initial Comments filed on April 20, 2020, in the above-referenced Docket.

Please contact me at (218) 723-3963 or dmoeller@allete.com if you have any questions regarding this filing.

Yours truly,

David R. Moeller

David R. Moeller
Senior Attorney and
Director of Regulatory Compliance

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Attach.

STATE OF MINNESOTA
BEFORE THE
MINNESOTA PUBLIC UTILITIES COMMISSION

In the Matter of Minnesota Power's Petition for Approval of its Capital Structure and Authorization to Issue Securities Under Minn. Stat. § 216B.49	Docket No. E015/S-20-279 **REPLY COMMENTS**

I. INTRODUCTION

Minnesota Power (or "the Company") submits these Reply Comments to the Minnesota Public Utilities Commission ("Commission") in response to the Department of Commerce – Division of Energy Resources ("Department") Initial Comments filed on April 20, 2020, in the above-referenced Docket. On February 13, 2020, the Company filed a Petition with the Commission seeking approval for its 2020 Capital Structure and Authorization to Issue Securities, including approval of a total equity ratio of 60.56% with a contingency window of +/-15% (51.48% to 69.64%). The Department requested that in its Reply Comments Minnesota Power:

- Provide supplemental information to what has already been provided about why granting ALLETE the option to increase its relative leverage would be reasonable and needed;
- Identify measures ALLETE is taking to insulate Minnesota Power and its ratepayers from the debt incurred to pursue non-regulated lines of business.
- Reconcile the information provided in Exhibits J and L to the statement made in ALLETE's February 13, 2020 earning call related to approximately $2 billion of projects scheduled in its CapEx planned for the next five years.
- Reconcile the clarifications provided in reply comments regarding the level of debt to be used for non-regulated operations, with the statement made on the February 13, 2020 earnings call on ALLETE's differentiated growth strategy being well supported by ALLETE's solid fundamentals and a longer runway of credit headroom enabling further non-regulated growth.

- Provide more detailed information about the specific projects that would warrant an increase in the debt ratio contingency range from 10% to 15% and why specifically this increased flexibility is needed and reasonable at this time.
- Confirm that the Company's capital structure for ratemaking purposes will not be affected by any changes regarding ALLETE's approved capital structure.

Minnesota Power appreciates the Departments time and effort in reviewing the Petition and developing it Initial Comments. The Company provides the following responses to the Department's requests and its recommendations.

II. Responses to Requested Information

Supplement the information provided in the petition about why granting the option to increase ALLETE's relative leverage – and to increase the maximum debt outstanding to $2.982 billion -- would be reasonable and needed including: 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 measures ALLETE is taking to insulate Minnesota Power and its ratepayers from the debt incurred to pursue non-regulated lines of business. Additionally, reconcile the information provided in Exhibits J and L to the following statements made by management in ALLETE's February 13, 2020 earnings call:

> ***"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."***

To clarify, ALLETE's request to increase the contingency range from 10% to 15% allows for increases to both the equity and debt ratios. This allows for greater flexibility to coincide with the nature of tax equity financing. Moreover, increased flexibility is important during the Coronavirus ('COVID-19") pandemic as ALLETE maintains liquidity. The non-regulated capital projects are ALLETE Clean Energy's ("ACE") South Peak and Diamond Spring as well as ALLETE South Wind's Nobles 2 project, all of which are renewable projects utilizing tax equity financing. Additionally, due to the uncertainty associated with potential projects, ALLETE must add room for supplemental debt and equity financing for projects unknown and unannounced at the time of the initial Capital Structure filing. These projects would not have been included in the Capital Expenditure table that was referenced from the 10-K filing during the February 13, 2020 earnings call. An example of this would be ACE's 300 MW Caddo Wind Project which was announced by ALLETE on March 12, 2020.

ALLETE's ability to utilize tax benefits is limited due to its accumulation of tax losses and unused production tax credits, so it needs to engage with a tax equity investor who can use the benefits economically. 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.

For these and new projects that utilize the Production Tax Credit (PTCs), Permanent financing will consist of equity and tax equity financing. As a result, the net debt to earnings before interest, taxes, depreciation and amortization ("EBITDA") after construction will go down.

Reconcile the clarifications provided in reply comments regarding the level of debt to be used for non-regulated operations management's statement 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."***

Both Moody's and S&P are paced on the growth of ALLETE's non-regulated businesses. ALLETE has and will remain prudent in financing its non-regulated projects appropriately within rating agency expectations to preserve its credit quality while attempting to diversify the Company. It should be noted the debt and equity issued for ALLETE's non-regulated operations does not impact the Minnesota Power capital structure because Minnesota Power's capital structure imputed and which is determined through the rate case process. Additionally, ALLETE appropriately capitalizes its subsidiaries to support the Company's credit ratings. The report S&P published on April 22, 2020 announcing ALLETE's downgrade stated the non-regulated businesses would need to exceed 20 percent of EBITDA to be downgraded and ACE is currently at only approximately 7 percent.

Unfortunately, ALLETE was downgraded by S&P on April 22, 2020, primarily due to weaker economic conditions and uncertainties related to COVID-19.

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.

To clarify, ALLETE's request to increase the contingency range from 10% to 15% allows for increases to both the equity and debt ratios. This allows for greater flexibility to coincide with the nature of tax equity financing that was highlighted above. Prior to 2009, Minnesota Power had been approved for +/- 15 % equity ratio contingency rate. The Department recommended in its initial comments in Docket No. E015/M-09-1233 that a +/- 10 % ratio is appropriate and went on to state, "In future capital structure a 15 percent range may be appropriate given an appropriate explanation by MP." In Minnesota Power's December 1, 2009, Reply Comments, the Company specifically agreed with the Department's recommendation that the equity ratio contingency range should be considered on a petition by petition basis and that a 15 % contingency range may be appropriate for Minnesota Power in future capital structure petitions. The Company feels that the reasons provided substantiate why it's appropriate for the Department to support, and the Commission to approve, the +/-15 % equity ratio contingency rate.

In the 2019 Capital Structure petition,[1] the Company requested the Commission allow removing the equity cap which would lower the debt to EBITDA ratio, strengthen the financial ratios, and would give the Company the additional financing flexibility needed to coincide with the nature and timing of tax equity financing. The Commission subsequently denied the request to remove the equity cap. The request to remove the equity cap was aimed at accomplishing the same thing as increasing the contingency range to 15 percent; allowing for the flexibility needed to coincide with tax equity financing.

In addition to Minnesota Power, ALLETE owns several business, regulated and non-regulated, that provide affordable, reliable energy services primarily in the Upper Midwest. In particular, the non-regulated businesses at ALLETE carry more equity. The non-

[1] Docket No. E015/S-19-170.

regulated projects are ACE’s South Peak and Diamond Spring as well as ALLETE South Wind’s Nobles 2 project, all of which are funded by equity and tax equity financing. Additionally, due to the uncertainty associated with potential projects, ALLETE must add room for supplemental debt and equity financing for projects unknown at the time of the initial Capital Structure filing. As a result, the potential exists that ALLETE’s equity ratio could increase by an amount greater than allowed by the +/-10 percent contingency window.

The Company is confident the proposed contingency range increase to 15 percent, at a minimum, does not increase the level of risk for customers, and may even lessen their risk. In fact, the Company has taken a more conservative approach with additional equity rather than issuing too much debt which concerns the Commission. The requested modification to the contingency range should be approved for the following reasons:

- The Department states that the Company “can file a new capital structure petition with the Commission at any time.” Although this is true, Minnesota Power is concerned with timely regulatory review due to the multiple complex dockets (e.g. rate cases, integrated resource plans, and integrated distribution plans) before the Commission as well as unknown complications or delays associated with COVID-19. Similar to the utility industry, the financial environment is continually changing; therefore, it is important that ALLETE has the flexibility to execute on business transactions.

- The proposed contingency range increase does not change the capital structure for Minnesota Power nor will it change what is applied in a rate case.

- Issuing equity improves ALLETE’s credit rating metrics which is beneficial to Minnesota Power and its customers. Using more equity in the capital structure lowers or “de-risks” financing to the benefit of customers. In the 2019 Capital Structure petition, the Company requested the Commission allow removing the equity cap which would give the Company the additional financing flexibility needed to coincide with the nature and timing of tax equity financing. The

Commission, with the recommendation of the Department, subsequently denied the request to remove the equity cap.

Given the ongoing general rate case, confirm that Minnesota Power's capital structure for ratemaking purposes will not be affected by any changes regarding ALLETE's approved capital structure.

Minnesota Power has an imputed capital structure that is set by the Commission through the regulatory process. Minnesota Power confirms that all non-regulated operations are carved out of MP's capital structure for ratemaking purposes.

III. Recommendations to the Commission

As part of its Initial Comments, the Department recommended that the Commission require the Company 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 nonregulated entities. Minnesota Power is agreeable to identifying in future capital structure petitions and compliance filings a historical account of what is allocated to Minnesota Power, ACE and other nonregulated entities.

IV. Conclusion

Prior to 2009, Minnesota Power had been approved for +/- 15 percent equity ratio contingency rate. In 2009, Minnesota Power agreed to the Department's recommendation that the equity ratio contingency range should be considered on a petition by petition basis because of the Department's acknowledgment that a 15 percent contingency range may be appropriate for Minnesota Power in future capital structure petitions. Up through June 2019, Minnesota Power had requested approval of a +/- 10 percent equity ratio contingency rate. However, the rapidly evolving energy industry and continually changing financial environment, especially over the past approximately 12 months, strengthens the importance for ALLETE to have greater flexibility to execute on business transactions. The COVID-19 pandemic further heightens the importance of greater flexibility as ALLETE maintains liquidity. Moreover, the proposed contingency range increase does not alter the capital structure for Minnesota Power nor will it change what is applied in a rate case. ALLETE respectfully requests approval of the proposed consolidated capital structure as presented in the Company's February 13, 2020 Petition.

Please contact me at (218) 723-3963 or dmoeller@allete.com if you have any questions regarding this filing.

Yours truly,

David R. Moeller
Senior Attorney and
Director of Regulatory Compliance

STATE OF MINNESOTA	)	AFFIDAVIT OF SERVICE VIA
	) ss	ELECTRONIC FILING
COUNTY OF ST. LOUIS	)	

Tiana Heger of the City of Duluth, County of St. Louis, State of Minnesota, says that on the 18th day of May, 2020, she served Minnesota Power's Reply Comments in **Docket No. E015/S-20-279** on the Minnesota Public Utilities Commission and the Energy Resources Division of the Minnesota Department of Commerce via electronic filing. The persons on E-Docket's Official Service List for this Docket were served as requested.

Tiana Heger