MINNESOTA
PUBLIC UTILITIES COMMISSION

Staff Briefing Papers

Meeting Date	May 21, 2020	Agenda Item 3 *
Company	Greater Minnesota Gas (GMG), Inc.	
Docket No.	**G022/S-19-727** In the Matter of the Petition of GMG for Approval of its 2020 Capital Structure and Permission to Issue Securities	
Issues	Should the Commission approve GMG's proposed 2020 capital structure and grant permission to issue long-term and short-term securities? Should the Commission consider revising the requirement for monthly capital structure compliance reports?	
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✓ **Relevant Documents**	**Date**
GMG - 2020 Capital Structure Petition	November 21, 2019
Department of Commerce – Comments	April 20, 2020
GMG - Reply	April 20, 2020

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I. Statement of the Issues

Should the Commission approve GMG's proposed 2020 capital structure and grant permission to issue long-term and short-term securities?

Should the Commission consider revising the requirement for monthly capital structure compliance reports?

II. Introduction

On November 21, 2019, GMG filed a petition seeking approval of its proposed 2020 capital structure and permission to issue securities within the scope of the proposed capital structure, plus contingencies.

On April 20, 2020, the Minnesota Department of Commerce, Division of Energy Resources (Department) submitted its comments, recommending approval with modifications. The modifications related to:[1]

a) an increase in total capitalization contingency; and
b) a gradual increase in GMG's equity ratio in GMG's next (2021) capital structure filing.

On April 20, 2020, GMG filed its reply stating that it has no objection to the Department's recommendation.

Staff is suggesting that the Commission may want to consider revising the requirement that GMG file monthly capital structure compliance reports.

The monthly reports are required to be filed 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 – that is, for example, a filing in April will reflect data for February.

Staff suggests that the Commission may want to instead require GMG to file a report, including a full explanation, when, for any month, GMG fails to meet the minimum equity ratio.

III. Summary of GMG's 2020 Capital Structure Initial Filing

GMG is seeking approval of its proposed 2020 capital structure with the following features:

[1] The Department has recommended that GMG maintain a minimum equity ratio of 34.0 percent at all times, and increase it to 35.0 percent by March 31, 2021. The Department has further recommended that GMG propose in its next capital structure petition a step-increase in its equity ratio floor from 35.0 percent to 36.0 percent beginning March 31, 2022.

- Total capitalization of up to $45.5 million, including the contingency of roughly $785,000;
- An equity ratio floor of 33.0 percent initially and increasing to 34.0 by March 31, 2020;[2]
- The ability to issue short-term debt not to exceed 10-percent of total capitalization at any time while the 2020 capital structure is in effect;
- 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
- Approval of the 2020 capital structure until the Commission issues a 2021 capital structure Order.

In recent years the Commission has expressed concern over GMG's equity position and required GMG to gradually increase its equity ratio.

In the 2019 capital structure filing (G-022/S-18-749), the Commission required GMG to maintain an equity ratio at all times of at least 31.59 percent, increasing it to 33.0 percent beginning March 31, 2019.

The Commission also directed GMG to make monthly compliance filings containing a balance sheet, income statement, and cash flow statement demonstrating that the requisite equity ratio was consistently maintained. GMG's monthly compliance filings demonstrated that its equity ratio did not fall below the floor of 33 percent.

The Commission also required GMG to propose in its next capital structure petition (the instant petition) a plan that:

a. reflects the increase in GMG's minimum equity ratio from 33.0 percent to 34.0 percent beginning March 31, 2020, or explain why such an increase is not possible;

b. would be expected to result in a 37.0 percent equity ratio by December 31, 2020, assuming normal weather, or explain why such an increase is not possible;

and

c. required GMG to propose in its next capital structure petition a step-increase in its equity ratio floor from 34.0 percent to 35.0 percent beginning March 31, 2021, or explain why such an increase is not possible.

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[2] GMG's April 13, 2020 compliance filing in its 2019 Capital Structure docket (G-022/S-18-749) reported an equity ratio of 37.26%.
https://www.edockets.state.mn.us/EFiling/edockets/searchDocuments.do?method=showPoup&documentId=%7b107B7471-0000-C011-A183-BBEB7D58D5A8%7d&documentTitle=20204-162042-01
In response to the Department's Interrogatory No. 3, GMG added that this ratio was "predicated on financials as of February 29, 2020."

The Table 1 below provides a comparison of GMG's actual capital structure as of September 30, 2019 and the proposed year-end 2020 capital structure:

Table 1

GMG's Actual and Projected Capital Structure Summary				
	Actual, September 30, 2019		**Proposed**, December 31, 2020	
	Amount	Percent	Amount	Percent
Short Term Debt	$ 1,489,500	3.51%	$ 1,500,000	3.35%
Long Term Debt	$ 26,454,491	62.95%	$ 26,666,796	59.64%
Common Equity	$ 14,083,757	33.51%	$ 16,548,159	37.01 %
Total Capitalization (excluding contingency)	$ 42,027,748	100.0%	$ 44,714,955	100.0%
Contingency			$ 785,045	1.76%
Total Capitalization w/ Contingency			$45,500,000	101.76%

Source: GMG Initial Filing, Attachment No. 3.

As noted in Table 1 above, GMG's petition projected an equity ratio of 37.01 percent by December 31, 2020, consistent with the Commission's Order in dkt. 18-749. GMG's filing also references the equity floor of 34.0 percent by the end of March 2020.

In its petition, GMG claims that it has significantly improved its financial performance and that a comparison of GMG's financial data to that of previous years generally shows continued year-to-year improvement notwithstanding weather changes and unexpected events such as the recent Tax Act changes. GMG concludes that it has continued to make safe, reliable, affordable natural gas service accessible to historically unserved rural Minnesota areas.

GMG notes that capital expenditures are necessary to maintain and improve existing plant, and expansion of plant, to support continued customer growth.

IV. Department's Comments

A. Compliance with Filing Requirements

Minn. Rules 7825.1000 – 7825.1500, Minn. Stat. §216B.49, and the Commission's May 12, 2009 Order in Docket No. E,G999/CI-08-1416 (the 08-1416 Order) contain general reporting requirements for capital structure petitions.

Further, as described above, the Commission's April 19, 2019 Order in GMG's 2019 Capital Structure Docket (18-749) imposed three specific requirements regarding the equity balance of GMG.

After review, the Department concluded that GMG has complied with all of the requirements established in Minn. Rules and the Commission's orders.

B. Department Analysis

In general, the Department's analysis shows that GMG's (pre-tax) financial performance during 2018 was comparable to its performance in 2017. For the 12 months ended September 30, 2019, the Department notes, GMG's performance improved. GMG's performance in 2020 is expected to maintain similar improvements.

The Department notes that GMG's proposed capital structure (Table 1, above) reflects an increase in total capitalization of $2.7 million (compared to the capital structure as of September 30, 2019) –comprised of $2.5 million increase in equity and $0.2 million increase in debt – suggesting, obviously, greater reliance on equity financing for system expansion. The Department indicated that GMG's need for additional capital continues to be driven by its system expansion efforts, although expenditures in this area are expected to be lower in 2020 than in recent years.

Even so, the Department stressed its ongoing concern with GMG's equity balance.

1. Equity Ratio

The Department's analysis shows that GMG's common equity increased by $0.8 million during the first nine months of 2019 because of increase in net income and increase in principal payments on outstanding debt.

Notwithstanding these improvements, the Department maintains that GMG's equity ratio remains low in comparison with similarly-situated natural gas utilities. The Department expressed its concern about risks inherent in a highly leveraged capital structure.

The Department compared GMG's equity position with the following natural gas utilities:

Table 2

Company	Ticker	Credit Rating	Short-Term Debt Ratio	Long-Term Debt Ratio	Common Equity Ratio	Other Equity Ratio	Total
Atmos Energy Corporation	ATO	A	4.77%	36.24%	58.99%	0.00%	100.00%
Northwest Natural Holding Company	NWN	A+	7.85%	46.55%	45.60%	0.00%	100.00%
ONE Gas, Inc.	OGS	A	13.02%	33.29%	53.68%	0.00%	100.00%
South Jersey Industries, Inc.	SJI	BBB	17.59%	52.90%	29.51%	0.00%	100.00%
Spire Inc.	SR	A-	13.74%	39.24%	42.54%	4.47%	100.00%
NiSource Inc.	NI	BBB+	11.24%	50.79%	32.38%	5.58%	100.00%
Southwest Gas Holdings, Inc.	SWX	BBB+	3.93%	47.77%	46.72%	1.58%	100.00%
Minimum			3.93%	33.29%	29.51%	0.00%	
Average			10.31%	43.83%	44.20%	1.66%	
Median			11.24%	46.55%	45.60%	0.00%	
Maximum			17.59%	52.90%	58.99%	5.58%	

The Department concluded that GMG's actual and projected equity ratios are significantly lower than this groups' average of 45.86 percent. The Department also expressed concern with the potentially negative effect of the COVID-19 pandemic on GMG's financial health.[3]

[3] GMG indicated that although the COVID-19 pandemic has caused increased expenses, greater

The Department, while agreeing that GMG's proposed 2020 capital structure represents an improvement, recommends that the Commission encourage still more improvement by requiring modest increases in GMG's equity position in the next capital structure filing.

The Department recommends the Commission approve an equity ratio contingency range floor of at least 34.00 percent, increasing to 35.0 percent on March 31, 2021.

The Department also recommends the Commission require GMG to include a proposal to increase its equity ratio floor from 35.0 percent to 36.0 percent by March 31, 2022 in its next filing.

The Department notes that the Commission often allows utilities to deviate from approved ranges for financial ratios a period of 60 days without Commission notification. However, in recent years the Commission has not granted that extra flexibility to GMG with respect to its equity ratio, and required GMG to maintain an equity ratio at or above its approved floor at all times. Given GMG's current, low equity ratio and the risks inherent in the Company's expansion strategy, the Department recommends that the Commission continue to enforce this restriction in this Docket.

2. Short-Term Debt Ratio

The Department finds GMG's proposal of a short-term debt contingency cap of ten percent of its total capitalization to be reasonable. The Department, however, emphasizes that GMG's equity ratio must remain at or above the approved floor 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 without Commission approval.

3. Long-term Debt Ratio

The Department pointed out that GMG has not requested a specific contingency range for the long-term debt ratio.[4] GMG has, however, requested the 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 explained that if GMG were to reduce its short-term debt ratio to zero after March 31, 2020, the maximum long-term debt ratio that would keep the Company within the proposed equity range would be 66.00 percent (equal to 100 percent minus 34.00 percent).

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customer arrears, and a loss in productivity of GMG's resources, it cannot yet be determined whether the impacts will be material. However, in the event that GMG becomes aware of a specific pandemic-related impact that would cause GMG to adjust its capital structure, GMG indicated that it will notify the Department and Commission of the same as soon as it is practicable.

[4] GMG's petition notes that GMG is "requesting approval to issue additional short- and long-term financing and contribute additional paid in capital as long as the Company maintains an equity ratio floor of 33.0%, increasing the floor to 34.0% by March 31, 2020, and total capitalization does not exceed $45.5 million."

The Department noted that GMG's proposal is consistent with its past several capital structure dockets.

The Department recommends the Commission permit the Company to issue long-term debt if GMG 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.

4. Total Capitalization

In its petition, GMG requested a capitalization of $44.7 million, with a contingency of $0.8 million, or 1.8 percent, for a total capitalization of $45.5 million.

The Department maintains that GMG's proposed total capitalization contingency is significantly less than the 10 percent capitalization contingency approved by the Commission in GMG's last several capital structure dockets.

The Department believes a 10 percent contingency is appropriate to protect the Company from unforeseen capital needs. The Department recommends a total capitalization of $44.7 million with a 10 percent contingency ($4.5 million) for a total of $49.2 million.

Table 3 below shows a comparison of the GMG's total capitalization and the Department's modification to GMG's total capitalization contingency:

Table 3

GMG v. Department Proposed 2020 Capital Structure Summary				
	GMG-Proposed		Department-Proposed	
	Amount	Percent	Amount	Percent
Short Term Debt	$ 1,500,000	3.35%	Same as GMG's proposal	
Long Term Debt	$ 26,666,796	59.64%		
Common Equity	$ 16,548,159	37.01%		
Total Capitalization (excluding contingency)	$ 44,714,955	100.0%		
Contingency	$ 785,045	1.76%	$4.5 million (rounded)	Approx. 10-percent of Total Cap.
Total Capitalization w/ Contingency	$45,500,000	101.76%	$49.2 million (rounded)	Approx. 110%

The Department cautioned that if GMG uses this total capitalization contingency, its equity ratio must still remain above the approved floor.

C. Department Recommendations

The Department recommends that the Commission:

1. approve GMG's proposed 2020 capital structure;

2. require that GMG maintain at all times an equity ratio contingency range of at least 34.00 percent, increasing to 35.0 percent beginning March 31, 2021;

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. approve a total capitalization contingency of $4.5 million above the estimated 2020 year-end total capitalization of $44.7 million, for a total capitalization of $49.2 million;

6. require GMG to file a new securities issuance and capital structure petition by January 1, 2021;

7. require GMG to propose in its next capital structure petition a plan that:

    a. would be expected to result in a 38.0 percent equity ratio by December 31, 2021, assuming normal weather, or explain why such an increase is not possible; and

    b. reflects the increase in GMG's minimum equity ratio from 34.0 percent to 35.0 percent beginning March 31, 2021, or explain why such an increase is not possible; and

8. require GMG to propose in its next capital structure petition a step-increase in its equity ratio floor from 35.0 percent to 36.0 percent beginning March 31, 2022, or explain why such an increase is not possible.

V. GMG's Reply Comments

On February 20, 2020, NSP-MN filed its Reply Comments indicating its acceptance of all of the Department's recommendations.

VI. Staff Analysis

Staff agrees with the Department's analysis, but with regard to the Department's recommendations, Staff suggests that the Commission revisit the requirement that GMG continue to file monthly reports.

Staff has ascertained that the requirement to file monthly reports was first recommended by the Department in Docket G022/S-12-1370 (GMG's 2013 capital structure filing) where the Department noted:

> To ensure that this minimal equity ratio is maintained, the Department recommends that the Commission require GMG to make monthly compliance filings containing a balance sheet dated the last day of the month, as well as income and cash flow statements for the month. The financial statements must show that GMG has maintained an equity ratio of at least 31.59 percent.

In recent years, the Commission has adopted the Department's recommendation to order GMG to increase its equity ratio, in particular the minimum limit of the range of equity.

In GMG's 2017 capital structure filing (G-022/S-16-931), the Commission required GMG to maintain a minimum equity ratio of at least 31.59 percent at all times; and to propose (in its next capital structure petition) a step-increase in the equity ratio floor from 31.59 percent to 33.0 percent beginning March 31, 2019.

In the 2018 capital structure filing (G-022/S-17-808), GMG did not seek an upper limit for its equity range; rather, GMG proposed an equity range of at least 31.59 percent during 2018. The Commission approved GMG's proposal and ordered GMG to submit a plan that showed a step increase in its equity-ratio floor from 33.00%, effective March 31, 2019, to 34.00% beginning March 31, 2020.

In GMG's 2019 capital structure filing (G-022/S-18-749), the equity <u>range</u> approved by the Commission consisted of <u>only the floor</u> of 31.59 percent (which was previously increased to 33.0 percent beginning March 31, 2019); and the Commission reiterated its earlier decision to raise the minimum equity ratio[5] from 33.0 percent, effective March 31, 2019, to 34.0 percent beginning March 31, 2020.

The following timeline shows the decisions taken recently to increase GMG's minimum equity ratio:

Dateline reflecting GMG's Minimum Equity Ratio

2018	Mar 31, 2019	Mar 31, 2020	Mar 31, 2021 (proposed)
31.59%	33%	34%	35%

The Department has further recommended that GMG propose in its next capital structure petition a step-increase in its equity ratio floor from 35.0 percent to 36.0 percent beginning March 31, 2022.

The range of common equity ratio for the comparable group of firms, as presented by the Department, varies from a minimum of 29.51% to a maximum of 58.99%; the average is 44.20% and the median is 45.6%. Although the proposed equity ratios for GMG are well below the median value, they are substantially above the minimum for the comparable group of firms.

The Commission has also adopted the Department's recommendation to require GMG to file monthly reports (including balance sheet, income statement, and cash flow statement)

[5] In all these cases, GMG is permitted to provide an explanation if it fails not maintain the equity floor.

demonstrating that GMG's equity ratio remains at or above the approved floor. The Department has, in this docket, recommended that the Commission continue this requirement. GMG has been in full compliance with the Commission's orders and in no case has GMG' equity ratio fallen below the floor. A review of GMG's compliance reports, May 2019 through March 2020 and for April 2020 shows that GMG is in full compliance.

The Department has noted that GMG's financial performance during 2018 was comparable to its performance in 2017; that for the 12 months ended September 30, 2019, the Company's performance improved; and that GMG has forecasted similar improvements in 2020. The Department has also noted that the interest coverage continued its steady increase.

The Department noted, in GMG's 2019 capital structure filing, GMG's interest coverage ratio "continued its steady increase."

GMG's interest coverage ratio increased from 2.1 in 2014 to 2.4 in September 2019 and is expected to reach 3.0 in 2020. This ratio is an estimate of how many times (three times by 2020) GMG can cover its current interest payment with its available earnings. While interest expense has increased very modestly over the period 2014-2019, from $0.9 million to $1.3 million, as percent of gross margin, the interest expense had decreased from 19% to 16.4% over the same period. The Department has indicated that GMG's "need for additional capital continues to be driven primarily by its continuing system expansion efforts, although expenditures in this area are expected to be lower in 2020 than in recent years."

The Department has indicated that GMG's common equity increased by $0.8 million during the first 9 months of 2019 as a result, partly, of improvement in GMG's net income. From Table 3 of the Department's comments, it can be seen that GMG's revenue grew from $12.1 million in 2014 to $14.5 million in 2019; and GMG's gross margin (revenue minus cost) nearly doubled, from $4.5 million to $8.2 million, over the same period. As percent of revenue, gross margin increased from 38% in 2014 to 56% in 2019.

In light of GMG's improved financial performance in recent years, and its ability to meet the minimum equity ratio on a monthly basis, Staff suggests that the Commission review the necessity of GMG's monthly reports. The Commission may order GMG to file an explanation when, at any month, the equity ratio falls below the floor and then consider remedial action.

Staff has made slight changes to the Department's other recommendations so that the decision alternatives better match the Department's analysis. These changes are not material and are highlighted in the next section.

In particular, Staff has added textual clarification to Decision Alternative 1, and added Decision Alternative 4. b., which appears to have been inadvertently omitted from the recommendations section of the Department's Comments

Decision Alternative 3.b. reflects reconsideration of monthly compliance reports.

VII. Decision Alternatives

1. approve GMG's proposed 2020 capital structure until the Commission issues a 2021 capital structure Order;

2. require that GMG maintain at all times an equity ratio contingency range of at least 34.00 percent, increasing to 35.0 percent beginning March 31, 2021;

3. a. 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; (GMG, DOC)

Or

3. b. authorize GMG to discontinue filing monthly compliance reports; require GMG to file reports, with full explanation, for any month it is not in compliance with the requirements; (PUC staff)

Or

3. c. Request GMG and the Department to address the need for GMG to continue monthly compliance reporting in GMG's next annual capital structure petition.

4. a. 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);

   b. approve a level of long-term debt that allows GMG the flexibility to issue securities provided that the Company remains within all of its authorized contingency ranges and does not exceed them for more than 60 days.

5. approve a total capitalization contingency of $4.5 million above the estimated 2020 year-end total capitalization of $44.7 million, for a total capitalization of $49.2 million;

6. require GMG to file a new securities issuance and capital structure petition by January 1, 2021;

7. require GMG to propose in its next capital structure petition a plan that:

   a. would be expected to result in a 38.0 percent equity ratio by December 31, 2021, assuming normal weather, or explain why such an increase is not possible; and

   b. reflects the increase in GMG's minimum equity ratio from 34.0 percent to 35.0 percent beginning March 31, 2021, or explain why such an increase is not possible; and

8. require GMG to propose in its next capital structure petition a step-increase in its equity ratio floor from 35.0 percent to 36.0 percent beginning March 31, 2022, or explain why such an increase is not possible.