Minnesota Public Utilities Commission

Staff Briefing Paper

Meeting Date: January 28, 2016 .... Agenda Item* # 2

Company:	Greater Minnesota Gas, Inc. (GMG)
Docket No:	G022/S-15-956 In the Matter of the Petition of Greater Minnesota Gas, Inc. for Approval of 2016 Capital Structure and Permission to Issue Securities.
Issue:	Should the Commission adopt the Department's recommendation to modify GMG's petition for approval of capital structure and permission to issue securities?
Staff:	Ganesh Krishnan .... ganesh.krishnan@state.mn.us; 651-201-2215 Clark Kaml .... clark.kaml@state.mn.us; 651-201-2246

Relevant Documents

GMG Initial Filing .... October 30, 2015
Department of Commerce Comments .... December 30, 2015
GMG Reply Letter .... December 30, 2015

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Statement of Issue

Should the Commission adopt the Department's recommendation to modify GMG's petition for approval of capital structure and permission to issue securities?

Introduction

The purpose this briefing paper is to highlight the Department's analysis and recommendation of the modification of GMG's petition regarding the equity ratio contingency range and the requirement to inject equity, or for GMG to take other action, such that the equity ratio is at least 31.59 percent.

Background

Requirements of the Commission's Order in GMG's 2015 Capital Structure Docket[1]

The Commission required GMG to file a new securities issuance and capital structure petition by January 1, 2016 with an equity ratio contingency range of 31.59 percent to 38.61 percent. The Order also approved an ongoing equity ratio contingency range of 31.00 percent to 38.61 percent; and, it required that GMG maintain an equity ratio contingency of at least 31.00 percent at all times, including amounts drawn on its line of credit.

GMG's Petition

GMG's petition is seeking approval of:

a. a capitalization of $36.3 million;
b. a capitalization contingency of $1.2 million ;
c. total capitalization of $37.5 million;
d. **equity ratio of 32.24 percent** and a contingency equity ratio range of **31.59 percent to 38.61 percent**;[2]
e. the ability to issue short-term debt not to exceed 10 percent of total capitalization at any time while the 2016 capital structure is in effect;
f. the flexibility to issue long-term debt provided that the Company remains within the equity and short-term debt contingency ranges and does not exceed them for more than 60 days; and
g. approval of the 2016 capital structure until the Commission issues a 2017 capital structure order.

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[1] Docket G-022/S-14-1051, Commission's Order dated May 26, 2015.
[2] The Department and GMG do not disagree regarding the capital structure ($36.3 million) -- equity ratio of 32.24 percent, short-term debt ratio of 3.27 percent, and long term debt ratio of 64.49 percent.

Essentially, 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 between 31.59 percent and 38.61 percent and total capitalization does not exceed $37.5 million.

GMG proposes to issue long-term debt for the purpose of financing its 2016 capital projects. GMG does not anticipate receiving a paid in capital contribution from its parent company (Greater Minnesota Synergy) to finance the 2016 capital projects. However, GMG requests that the Commission authorize the contribution of additional paid in capital, if necessary, to maintain at least a 31.59 percent equity ratio contingency range in GMG's 2016 capital structure.

Department's Comments

Although the Department "recommends **approval, with modifications**," and "**approve GMG's proposed 2016 capital structure**,"[3] the modifications are very significant and result in a proposal different from GMG's initial proposal. The Department notes that its recommendations are intended to allow GMG some flexibility to pursue its expansion projects while maintaining a minimum degree of financial integrity.

In the following, Staff has itemized the Department's recommendations:

a. approve a capitalization of $36.3 million, as proposed by GMG;
b. approve a capitalization **contingency of $3.6 million** above the estimated 2016 year-end total capitalization;
c. approve a **total capitalization of $40.0 million**;
    1. approve common equity ratio of 32.24 percent, short-term debt ratio of 3.27 percent, and long term debt ratio of 64.49 percent;[4]
    2. approve an **equity ratio contingency range of 31.00 percent** to 38.61 percent;
    3. require GMG, if its equity ratio is less than 31.59 percent on December 31, 2016, to inject equity or make other changes such that its equity ratio is at least 31.59 percent;
    4. require that GMG maintain an equity ratio of at least 31.00 percent at all times;
    5. require GMG 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, demonstrating that its equity ratio is at least 31.00 percent;
d 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); and
e. require GMG to file a new securities issuance and capital structure petition by

[3] Presumably, this portion of the recommendation refers to the capital structure ($36.3 million): equity ratio of 32.24 percent, short-term debt ratio of 3.27 percent, and long term debt ratio of 64.49 percent.
[4] Source: Table 4, the Department's Comments, p. 7.

January 1, 2017.

The Department's modifications spring from its conclusion that GMG is in a precarious financial position. However, the Department supports GMG's plan to add profitable, high-volume customers to its system provided there is close scrutiny of GMG's capital structure via monthly compliance filings.

GMG's Reply Letter

GMG in its reply letter notes:

> GMG appreciates the Department's carefully considered analysis and its recommendation that the Commission approve the Petition. GMG submits that no additional issues require discussion prior to the Commission's consideration. Therefore, GMG respectfully requests that the matter be placed on a Commission meeting agenda.

Highlights of the Department's Analysis and Recommendation

The Department notes GMG's "improved ability to meet its debt obligations," while also remarking that GMG's current and proposed equity ratios are significantly lower than the average equity ratio of risk-comparable gas utilities. The Department also notes that GMG does not plan to take actions to increase its equity ratio during the next few years and that GMG plans to maintain its highly leveraged capital structure by continuing to issue as much debt as its net income (which is added to equity) will allow while maintaining an equity ratio of at least 31.59 percent in order to fund its capital spending.

Although the Department has recommended that the Commission approve GMG's proposed capital structure of $36.3 million, consisting of 32.24 percent of common equity, short-term debt of 3.27 percent, and long term debt of 64.49 percent,[5] this recommendation is subject to several conditions or modifications.

The conditions proposed by the Department arise from the Department's concern that GMG's current and proposed equity ratios are significantly lower than the average equity ratio of risk-comparable gas utilities. The Department notes that it is still concerned with the financial health of GMG despite improvements observed over the last few years.

The Department observes that although GMG has requested approval of the equity ratio **contingency range of 31.59 percent to 38.61 percent,** GMG's equity ratio (**as required by the**

[5] Source: Table 4, the Department's Comments, p. 7. The Department notes that "GMG's proposed capital structure reflects an increase in total capitalization of $4.2 million, comprised of $2.4 million in equity and $1.8 million in total debt" over the actual capital structure as of August 31, 2015. The figures are $2.4 million in long-term debt and $1.8 million in common equity.

Commission's May 26, 2015 Order), as of October 31, 2015, it was only **31.26 percent** (slightly below the lower limit ordered by the Commission). The Department concludes that if the Commission were to approve GMG's requested contingency range, GMG would immediately become non-compliant absent an improvement in the Company's equity ratio.

The Department notes that the Commission, rather than requiring GMG to adjust its business expansion plans, lowered GMG's equity ratio floor to 31.00 percent (in the 2015 capital structure docket), while also simultaneously requiring an equity ratio floor of 31.59 percent in the next capital structure petition with the expectation that GMG would be able to raise its equity ratio enough to meet this requirement. In the Department's estimation, GMG has not done so.

The Department recommends a slight **downward revision to the lower limit of the equity contingency range from 31.59 percent to 31.00 percent** with the condition that if GMG's equity ratio is less than 31.59 percent <u>as of December 31, 2016</u>, GMG be required to inject equity to raise it equity ratio to at least 31.59 percent. The Department recommends GMG to maintain an equity ratio contingency range of at least 31.00 percent <u>at all times</u> without the flexibility to violate approved ranges for a period of 60 days (often allowed to utilities) without Commission notification. The Department also recommends that the Commission continue the current requirement that GMG make monthly compliance filings demonstrating that its equity ratio is at or above the approved floor.

With regard to **short-term debt contingency**, the Department recommends approval of GMG's proposal of a short-term debt contingency cap of ten percent of its total capitalization. However, the Department warns that because GMG's equity ratio should remain at or above 31.00 percent at all times, and given GMG's current equity ratio of only 31.26 percent, "GMG would have little flexibility to issue short-term debt and as a result, short-term financing needs would have to be met with equity." 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, but not (as noted previously), the proposed equity ratio floor.

The Department notes that GMG did not request a specific contingency range for its **long-term debt** ratio. GMG, instead, requested the flexibility to issue long-term debt provided that it remained within its equity and short-term debt contingency ranges and did not exceed them for more than 60 days. The Department observes that if GMG were to reduce its short-term debt ratio to zero, the maximum long-term debt ratio that would keep the Company within the proposed equity range would be 69.00 percent (equal to 100 percent minus 31.00 percent).

Finally, **regarding total capitalization**, GMG requested approval of a total capitalization of $36.3 million, with a contingency of $1.2 million, for a maximum capitalization of $37.5 million. The Department notes that the contingency amount of $1.2 million is equal to 3.2 percent of GMG's proposed capitalization, significantly less than the 10 percent capitalization contingency approved by the Commission in GMG's three most recent capital structure dockets. The

Department concludes that a 10 percent contingency is appropriate to protect the Company from unforeseen capital needs. The Department reiterates, however, that if GMG uses this total capitalization contingency, it must maintain an equity ratio of at least 31.00 percent.

Decision Alternatives

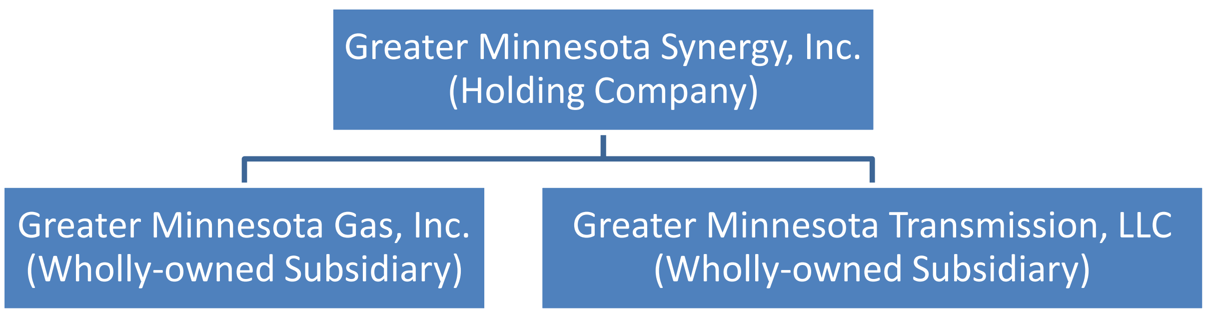
Should the Commission adopt the Department's recommendation to modify GMG's petition for approval of capital structure and permission to issue securities?

A. Approve the Department's recommendation:

a. approve a capitalization of $36.3 million, as proposed by GMG;
b. approve a capitalization **contingency of $3.6 million** above the estimated 2016 year-end total capitalization;
c. approve a **total capitalization of $40.0 million**;
    1. approve common equity ratio of 32.24 percent, short-term debt ratio of 3.27 percent, and long term debt ratio of 64.49 percent;[6]
    2. approve an **equity ratio contingency range of 31.00 percent** to 38.61 percent;
    3. require GMG, if its equity ratio is less than 31.59 percent on December 31, 2016, to inject equity or make other changes such that its equity ratio is at least 31.59 percent;
    4. require that GMG maintain an equity ratio of at least 31.00 percent at all times;
    5. require GMG 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, demonstrating that its equity ratio is at least 31.00 percent;
d. 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); and
e. require GMG to file a new securities issuance and capital structure petition by January 1, 2017.

B. Other action.

[6] Source: Table 4, the Department's Comments, p. 7.


Greater Minnesota Synergy, Inc.
(Holding Company)
Greater Minnesota Gas, Inc.
(Wholly-owned Subsidiary)
Greater Minnesota Transmission, LLC
(Wholly-owned Subsidiary)