MINNESOTA
PUBLIC UTILITIES COMMISSION

Staff Briefing Papers

Meeting Date	April 18, 2019		Agenda Item 4*
Company	Greater Minnesota Gas, Inc. (GMG)		
Docket No.	**G-022/S-18-749**		
	In the Matter of Greater Minnesota Gas, Inc.'s Petition for Approval of 2019 Capital Structure and Permission to Issue Securities		

Issues

1. Should the Commission require GMG to revise its accounting to reflect a five-year amortization of the change in GMG's deferred tax asset?

2. Should the Commission modify GMG's petition for approval of 2019 capital structure and permission to issue securities as recommended by the Department?

3. Does the Commission need to clarify the requirements for meeting the equity ratio target and equity ratio floor for 2020?

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✓ **Relevant Documents**	**Date**
GMG – Petition (Trade Secret)	December 4, 2018
Department of Commerce – Comments	February 4, 2019
GMG – Reply Comments	February 6, 2019

I. Statement of the Issues

1. Should the Commission require GMG to revise its accounting to reflect a five-year amortization of the change in GMG's deferred tax asset?
2. Should the Commission modify GMG's petition for approval of 2019 capital structure and permission to issue securities as recommended by the Department?
3. Does the Commission need to clarify the requirements for meeting the equity ratio target and equity ratio floor for 2020?

II. Introduction

On December 4, 2018, Greater Minnesota Gas, Inc. (GMG) filed a petition for approval of its 2019 capital structure and permission to issue securities.

On February 4, 2019, the Minnesota Department of Commerce, Division of Energy Resources (Department) filed its Comments recommending approval of GMG's petition with modifications.

On February 6, 2019, GMG submitted reply comments accepting the Department's recommendations and modifications on the condition that GMG correctly understands the Department's recommendations. GMG also provided further explanation for the calculation of its capital structure and how that was impacted by the Tax Cut and Jobs Act (TCJA) refund.

III. Should the Commission require GMG to revise its accounting to reflect a five-year amortization of the change in GMG's deferred tax asset?

The Commission's April 17, 2018 Order in GMG's 2018 Capital Structure Docket (17-808) imposed a number of requirements on GMG, including a requirement that GMG's 2019 capital-structure filing include a plan that would be expected to result in a 36.50% equity ratio by December 31, 2019, assuming normal weather, or an explanation of why such an increase is not possible. GMG's Petition projects an equity ratio of 35.93% by December 31, 2019, and on page three of its Petition, GMG explained that changes resulting from the Tax Cuts and Jobs Act (TCJA), made it impossible for GMG's equity ratio to reach 36.50% by the end of the year.

GMG estimated that the impact of the TCJA will reduce its December 31, 2019 equity ratio by 0.81 percent, or 81 basis points from 36.74% to the projected 35.93%.

A. Department Comments

The Department stated

> that this 81 basis point reduction is a result of GMG expensing the full reduction of its deferred tax asset in 2017, rather than amortizing that reduction over a five year period as contemplated in the Commission's December 5, 2018 Order in Docket No. E,G999/CI-17-895 (the TCJA Docket), the Commission's investigation into the effects of the TCJA. While that Order does not explicitly state that GMG

> was required [to] amortize the reduction in its deferred tax asset over five years, the Order does explicitly require GMG to reduce its rates to reflect the $48,258 of savings attributable to the TCJA. That savings estimate reflects a five-year amortization of the $365,000 decrease in GMG's deferred tax asset, indicating that the Commission's intention was for GMG to amortize the reduction.
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> Had GMG amortized the reduction over a period of five years, rather than recognizing the entire expense in 2017, the impact to its equity ratio as of December 31, 2019, would have been only 56 basis points, meaning the Company's equity ratio proposal for year-end 2019 would have been 36.49 percent. [Citation omitted.]

The Department further stated:

> The Commission may wish to order GMG to revise its accounting to more accurately reflect the Commission's Order in the TCJA Docket by incorporating a five-year amortization of the change in the Company's deferred tax asset. However, the Commission could determine that it is not necessary to order GMG to revise its accounting, for the following reasons. First, while ordering GMG to reflect the five-year amortization period in its books would better reflect the Commission's Order and also result in a higher equity ratio for GMG, it would not change the Company's fundamental economic or financial position. In other words, over time, GMG's revenues, expenses, and equity balances will likely be the same regardless of whether it revises its accounting. Only if GMG files a rate case during the amortization period will rates be affected, and even then, unless GMG includes an adjustment to reflect the unamortized portion of the deferred tax asset and the associated amortization expense, the result will be lower rates. Absent a rate case, the continuing compliance process in the TCJA Docket will ensure that GMG's rates are just and reasonable. For these reasons, the Department does not recommend that the Commission order GMG to revise its accounting to better reflect the Order in the TCJA Docket.

B. GMG Reply Comments

In its Reply Comments, GMG stated:

> As the Commission is aware, the TCJA ultimately resulted in GMG's reduction of a significant deferred tax asset. The Department noted in its Comments that GMG expensed the full reduction of the deferred tax asset in 2017 rather than amortizing it over a five year period. The Department opined that the Commission's Order in Docket No. E,G999/CI-17-895 (the TCJA treatment docket) predicated GMG's ordered rate reduction on a savings estimate that reflected a five year amortization period of the asset reduction; and, that approach indicated that the Commission's intention was for GMG to amortize the reduction over time. However, as the Department recognized in its Comments, the Commission's Order did not explicitly require GMG to amortize the reduction over five years. Additionally, the Order did not clearly provide GMG with the right to do so. GMG

and its auditors believe that, absent an express directive or explicit grant of authority from the Commission, GMG is obligated to comply with GAAP [Generally Accepted Accounting Principles].

C. Staff Analysis

The Commission's December 5, 2018 *Order Responding to Changes in Federal Tax Law*, in the TCJA docket 17-895, required GMG, among other things, to reduce its base rates, consistent with its current rate design, to reflect net annual savings of $48,258. The net annual savings of $48,258 was calculated as follows: Current Period Tax Expense of $34,531 + Tax Gross-up on Revenue Requirement Deficiency of $119,212 = $153,743 annual amount to be refunded without considering the deferred tax asset reduction. GMG had positive excess Accumulated Deferred Income Taxes (ADIT) in Rate Base (a deferred tax asset) of an estimated $365,000 proposed to be amortized over 5 years and grossed up. $365,000/5 years = $73,000; $73,000 * 1.4450 gross up factor = $105,485.

The $153,743 annual amount to be refunded without considering the deferred tax asset less the amount of ADIT amortized over a 5 year period with gross up $105,485 is the $48,258 amount by which GMG was required to reduce its base rates.

Thus, the $365,000 was amortized over 5 years for ratemaking and refunding purposes, but for the purpose of financial statements from which the capital structure comes, the $365,000 was expensed in a single year. There is a mismatch or difference in this instance between the accounting for ratemaking and refunding purposes and what is indicated by GAAP.

Although a five year amortization of the Deferred Tax Asset was implicit in the Commission's TCJA docket required rate reduction and the Commission could require GMG to revise its accounting to reflect a five-year amortization, the TCJA Order did not authorize GMG to set up a regulatory asset for the unamortized balance. Staff believes GMG was correct in writing off the entire $365,000 in a single year despite the fact that a five-year amortization is implicit in the rate reduction calculation. Writing off the entire $365,000 in one year is a more conservative approach and staff agrees that the net effect to GMG's economic or financial position over time appears to be minimal, if anything at all. Staff agrees with the Department (and GMG) and would not recommend that the Commission require GMG to revise its accounting.

IV. Should the Commission modify GMG's petition for approval of 2019 capital structure and permission to issue securities as recommended by the Department?

Does the Commission need to clarify the requirements for meeting the equity ratio target and equity ratio floor for 2020?

A. GMG's Petition

GMG is seeking approval of its 2019 proposed capital structure and permission to issue securities for the following:

- Total capitalization of up to $44 million, including the contingency.
- An equity ratio floor of 31.59 percent initially and increasing to 34.0 by March 31, 2020.
- The ability to issue short-term debt not to exceed ten percent of total capitalization at any time while the 2019 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.
- Approval of the 2019 capital structure until the Commission issues a 2020 capital structure Order.

B. Department Comments

The Department proposes two sets of modifications.

First, regarding GMG's proposed 2019 capital structure, the Department recommends the Commission:

- Approve an equity ratio contingency range of at least 31.59 percent, increasing to 33.0 percent on March 31, 2019;
- Require GMG to make monthly compliance filings demonstrating that GMG's equity ratio remained at or above the approved floor; and
- Require GMG to maintain a total capitalization of $43.3 million with a 10 percent contingency ($4.3 million as opposed to GMG's proposed contingency of $0.7 million) for a total of $47.6 million.

Second, the Department proposes the following three requirements affecting GMG's next capital structure filing in 2020.

- Require GMG to file its next capital structure petition by January 1, 2020.
- Require GMG to propose in its next capital structure petition a plan that:
    - 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
    - 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.
- Require 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.

In conclusion, the Department recommended the Commission:

1. Approve GMG's proposed 2019 capital structure;

2. Require that GMG maintain at all times an equity ratio contingency range of at least 31.59 percent, increasing to 33.0 percent beginning March 31, 2019;

3. 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;

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 $4.3 million above the estimated 2019 year-end total capitalization of $43.3 million, for a total capitalization of $47.6 million;

6. Require GMG to file a new securities issuance and capital structure petition by January 1, 2020;

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

    a. 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

    b. 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; and

8. Require 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.

C. GMG Reply Comments

On February 6, 2019, GMG filed its Reply Comments.

GMG stated that it "requests that the Commission approve its 2019 proposed capital structure and grant permission to issue securities in accordance with the limits and contingencies identified in the Department's Comments, assuming that GMG's understanding of the recommendations is correct."

GMG explained that:

> . . . GMG does not object to the principle of developing a forward-looking capital structure that advances its equity ratio by one percent at both year end and for the equity ratio floor for the given time period. Therefore, GMG agrees to the Department's proposal that its next capital structure petition contain a plan that is designed to result in an equity ratio of 37.0 percent by December 31, 2020 and an equity ratio floor of 35% by March 31, 2021, assuming normal weather conditions and no unforeseen expenses, or that it will explain why such an increases are not possible.
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> GMG would like to clarify, however, that its understanding of the Department's recommendation with regard to both the equity ratio and the equity ratio [floor] provides for variance if GMG falls short due to things beyond the Company's control such as abnormally warm weather, unanticipated tax increases or regulatory mandates, substantial materials cost increases, etc., as long as GMG advises the Commission of that situation and provides an explanation for the same. Assuming that GMG's interpretation of the Department's recommendation is consistent with the Department's intent, then GMG agrees to the Department's recommendations.

D. Staff Analysis

GMG appears to be in agreement with the Department's proposed modifications. Since the Department has the phrase "or explain why such an increase is not possible" in recommendations with respect to the target equity ratio and equity ratio floor, staff does not believe any clarification is necessary.

V. Decision Alternatives

Should the Commission require GMG to revise its accounting to reflect a five-year amortization of the change in GMG's deferred tax asset?

1. Require GMG to revise its accounting and capital structure to reflect a five-year amortization of the change in GMG's deferred tax asset.

2. Take no action.

Should the Commission modify GMG's petition for approval of 2019 capital structure and permission to issue securities as recommended by the Department?

3. Approve GMG's proposed 2019 capital structure;

4. Require that GMG maintain at all times an equity ratio contingency range of at least 31.59 percent, increasing to 33.0 percent beginning March 31, 2019;

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;

6. 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);

7. Approve a total capitalization contingency of $4.3 million above the estimated 2019 year-end total capitalization of $43.3 million, for a total capitalization of $47.6 million;

8. Require GMG to file a new securities issuance and capital structure petition by January 1, 2020;

9. Require GMG to propose in its next capital structure petition a plan that:

   a. 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

   b. 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; and

10. Require 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.

Does the Commission need to clarify the requirements for GMG meeting the equity ratio target and equity ratio floor for 2020?

11. Clarify that the requirements with regard to an equity ratio target and equity ratio floor for 2020 provides for variance if GMG provides an adequate explanation for why it fell short of the targets due to things beyond the Company's control; or

12. Clarify that the requirements with regard to an equity ratio target and equity ratio floor for 2020 do not provide for variance if GMG falls short due to circumstances beyond the Company's control; or

13. Take no action.