

July 31, 2017

Daniel P. Wolf
Executive Secretary
Minnesota Public Utilities Commission
121 7th Place East, Suite 350
St. Paul, Minnesota 55101-2147

RE: **Comments of the Minnesota Department of Commerce, Division of Energy Resources**
Docket No. E017/S-17-337

Dear Mr. Wolf:

Attached are the Comments of the Minnesota Department of Commerce, Division of Energy Resources (Department) in the following matter:

In the Matter of the Petition of Otter Tail Power Company for Approval of 2017 Capital Structure and Permission to Issue Securities.

The petition was filed on May 1, 2017 by:

Todd Wahlund
Vice President, Financial Planning and Treasurer
Otter Tail Corporation
215 S. Cascade St.
P.O. Box 496
Fergus Falls, MN 56538-0496

The Department recommends approval and is available to answer any questions the Minnesota Public Utilities Commission may have.

Sincerely,

/s/ CRAIG ADDONIZIO
Financial Analyst

CA/lt
Attachment

Before the Minnesota Public Utilities Commission

Comments of the Minnesota Department of Commerce Division of Energy Resources

Docket No. E017/S-17-337

I. SUMMARY OF THE UTILITY'S PROPOSAL

On May 1, 2017, Otter Tail Power Company (Otter Tail or the Company) filed a petition (Petition) with the Minnesota Public Utilities Commission (Commission) requesting approval of its proposed 2017 capital structure, and the authority to issue securities such that the Company would remain within certain contingency ranges around its proposed capital structure.

Table 1 summarizes the Company's proposed 2017 capital structure.

Table 1
Otter Tail's Proposed 2017 Capital Structure

	(\$ Millions)	(%)
Short-Term Debt	94.3	8.8%
Long-Term Debt	412.0	38.5%
Common Equity	564.6	52.7%
Total Capitalization	1,070.9	100.0%

With respect to its capital structure, Otter Tail also requested approval of:

- a contingency range of plus or minus 10 percent around its proposed common equity ratio of 52.7 percent (i.e. a range of 47.4 percent to 58.0 percent);
- a contingency cap on its total capitalization of 10 percent above the proposed amount of \$1,070,931,000 (i.e. a cap of \$1,178,024,000);
- a short-term debt contingency cap of 15 percent of its total capitalization (i.e. up to \$160.6 million).

Otter Tail requested that its proposed capital structure be in force from the date of the Commission's Order in this Docket until the Commission issues a subsequent capital structure Order for the Company.

Otter Tail also requested authority to issue any of the following securities, provided that the Company does not exceed the proposed contingency ranges for a period greater than 60 days:

- securities evidencing long-term debt, including First Mortgage Bonds and other secured or unsecured debt obligations;
- common equity; and
- short-term unsecured debt.

Finally, Otter Tail requested a continuation of a variance of Minn. Rules 7825.1000, subp. 6 to allow the Company to treat borrowing under its multi-year credit facility (MYCF) as short-term debt for approved capital structure purposes.

II. DETAILS OF OTTER TAIL'S PROPOSAL

Table 2 provides the Company's recent capital structures as well as its projected capital structure as of the end of 2017, which is also its proposed 2017 capital structure.

Table 2
Otter Tail's Recent and Projected
Capital Structures

	July 31, 2016		December 31, 2016		December 31, 2017	
	Actual		Actual		Projected	
	(\$ Millions)	(%)	(\$ Millions)	(%)	(\$ Millions)	(%)
Short-Term Debt	32.1	3.2%	42.9	4.2%	94.3	8.8%
Long-Term Debt	445.0	43.8%	445.0	43.1%	412.0	38.5%
Common Equity	537.8	53.0%	545.2	52.8%	564.6	52.7%
Total Capitalization	1,014.9	100.0%	1,033.0	100.0%	1,070.9	100.0%

Source: Petition, Attachment 1

As shown, Otter Tail projects increases in its short-term debt and equity balances, and a decrease in its long-term debt balance; the combined effect of these changes is an increase in Otter Tail's total capitalization of \$37.9 million (3.7 percent increase). The projected \$33.0 million decrease in the Company's long-term debt balance results from the coming maturation of \$33.0 million note in August 2017. The Company plans to temporarily refinance this note with short-term debt before combining it with a larger debt financing in 2018.¹ This refinancing accounts for most of the projected increase in short-term debt.

¹ Petition, Attachment 1.

As shown in Attachment 10A to the Company's Petition, Otter Tail expects its total uses of cash during 2017 to amount to \$226.5 million. The majority of this cash, \$135.3 million, will be used for capital expenditures, as detailed in Attachment 10B. An additional \$41.0 million will be paid to Otter Tail Corporation (OTC), the Company's parent entity, as dividends, \$33.0 million will be used to retire long-term debt, and \$10.0 million will be contributed to the Company's pension plan.

Otter Tail plans to use internally generated cash flows, short-term debt and equity provided by OTC to meet its financing needs and for its 2017 capital expenditure plan. Per Attachment 10, page 3, Otter Tail expects to generate \$130 million from operations during 2017. For its short-term borrowings, Otter Tail plans to draw on its \$170 million MYCF to temporarily refinance its maturing \$33.0 million note and support its working capital needs and capital expenditure program until such time as it makes sense to roll these short-term borrowing into a long-term financing arrangement. The projected increase in Otter Tail's short-term debt balance from \$42.9 million to \$94.3 million is indicative of Otter Tail's plans to draw on its MYCF. Finally, Otter Tail expects to receive \$10 million in equity contributions from OTC during 2017.

III. FILING REQUIREMENTS AND COMPLIANCE WITH PRIOR COMMISSION ORDERS

A. FILING REQUIREMENTS

Minnesota Rules 7825.1000 – 7825.1500 contain a number of filing requirements for capital structure petitions. After review, the Department concludes that Otter Tail has met the requirements set forth in Minnesota Rules 7825.1000–7825.1500.

B. COMPLIANCE WITH THE COMMISSION'S ORDER IN DOCKET NO. E017/S-16-367

The Commission's August 2, 2016 Order (the 2016 Order) in Otter Tail's 2016 capital structure petition (Docket No. E017/S-16-367) included the following order points:

6. Required OTP to provide, within 20 days after each non-recurring issuance of securities, the following information:
 - a. the specific purposes for individual issuances
 - b. the type of issuances;
 - c. the timing of issuances;
 - d. the amounts of issuances;
 - e. issuance costs (for common equity issuances, including price per share), and
 - f. interest rates.

7. Required OTP to provide, in its next capital structure filing, an exhibit showing a general projection of capital needs, projected expenditures, anticipated sources, and anticipated timing, with the understanding that such exhibit is not intended to require dollar-for-dollar spending on the uses identified in the exhibit or to limit issuances to project-specific financing. The exhibit need not list short-term, recurring security issuances.
8. Required OTP to provide in its next annual capital structure filing, a schedule comparing its actual capital investments in the past year with the capital investments projected by OTP in its previous capital structure filing.
9. Required OTP to provide in its next annual capital structure filing, the Company's investment plan not only for the next year, but for at least the next five years.
10. Approved OTP's request for a variance to allow it to treat any loan under its multi-year credit facility as a short-term debt and require OTP to report on its use of such facilities, including:
 - how often they are used;
 - the amount involved;
 - rates and financing costs; and
 - the intended uses of the financing.
11. Required OTP to file its 2017 capital structure filing by May 1, 2017.

The Department discusses these filing requirements below.

1. Information Regarding Non-Recurring Issuances of Securities

On November 18, 2016, Otter Tail filed a compliance filing in Docket No. E107/S-16-367 regarding an October 31, 2016 amendment to the Company's revolving credit facility containing the information required by Point 6 of the 2016 Order. The amendment extended the termination date of the facility from October 29, 2020 to October 29, 2021 and made certain other immaterial changes. Based on its review, the Department concludes that, with its November 18, 2016 compliance filing in Docket No. E107/S-16-367, Otter Tail complied Order Point 6 of the 2016 Order.

2. Projected Capital Needs and Anticipated Resources

Attachments 10A and 10B to the Company's Petition provide the information required by Order Point 7 of the 2016 Order. Attachment 10A shows Otter Tail's actual sources and uses of cash

for 2016 and projected sources and uses for 2017. Attachment 10B of the Company's filing provides Otter Tail's projected capital expenditures for the period 2017-2021 by four categories: Energy Supply, Transmission, Distribution and General.

Based on its review of Attachments 10A and 10B, the Department concludes that Otter Tail has complied with Order Point 7 of the 2016 Order.

3. Comparison of Actual and Projected Capital Investment

Attachment 10C to the Company's Petition contains a reconciliation of Otter Tail's budgeted 2016 capital expenditures and its actual 2016 capital expenditures. As shown, the Company's actual capital expenditures of \$142.1 million was approximately \$15.3 million, or 9.8 percent less than the budgeted amount, \$157.4 million. Actual capital expenditures on the Big Stone Area Transmission project during 2016 were \$17.0 million less than budgeted, and expenditures on other transmission projects were \$5.0 million less than budgeted. Capital expenditures on distribution plant and wind additions were \$7.8 million and \$1.8 million higher than budgeted, respectively.

4. The Company's Investment Plans

Attachment 10-B to the Company's Petition contain projected capital expenditures by category (production, transmission, distribution, and general) for the five-year period 2017-2021. Based on its review of this Attachment, the Department concludes that Otter Tail complied with Order Point 9 of the 2016 Order.

5. Report on Otter Tail's Use of its Multi-Year Credit Facility

Attachment 11 to the Company's Petition provides information regarding Otter Tail's use of its multi-year credit facility (MYCF) during 2016. As reported, the average month-end outstanding balance during 2016 was \$30.6 million, and Otter Tail paid a total of \$1.0 million in fees and interest. Funds drawn from the MYCF were used to support working capital needs and other capital requirements, including letters of credit in an aggregate amount not to exceed \$50.0 million outstanding at any point in time.

Based on its review, the Department concludes that Otter Tail complied with Order Point 10 of the 2016 Order.

C. COMPLIANCE WITH THE COMMISSION'S ORDER IN DOCKET NO. E,G999/CI-08-1416

The Commission's May 12, 2009 *Order Augmenting Information Required in Connection with Securities Issuances and Annual Capital Structure Filings* in Docket No. E,G999/CI-08-1416 (the 2009 Order) imposed certain filing requirements on utilities' capital structure filings. Points 1 and 4 of the 2009 Order are largely identical to Points 7 and 6 of the 2016 Order, and therefore the Department concludes that Otter Tail complied with them.

Order Point 3 of 2009 Order imposes the following requirement:

3. Starting with the utilities' next annual capital structure filings, the utilities shall include a report of actual issuances and uses of the funds from the prior year. The report will be for information purposes only and need not cover short-term, recurring security issuances.

Attachment 10A to the Company's Petition provides the required information. The Department concludes that Otter Tail complied with all requirements imposed by the 2009 Order.

IV. DEPARTMENT ANALYSIS

A. CAPITAL STRUCTURE

To check the reasonableness of Otter Tail's proposed 2017 capital structure, the Department compared it to the capital structures of publicly traded electric utilities that are risk-comparable to Otter Tail. As shown in Department Attachment 1, the average 2016 equity ratio for publicly traded electric utilities with bond ratings from Standard and Poor's from BBB- to BBB+ was 44.0 percent, and ranged from 21.7 percent to 59.2 percent.² While Otter Tail's proposed equity ratio is higher than the average, it is well within the range of risk-comparable electric utilities, and 5 of the 14 companies in the comparison group have equity ratios higher than Otter Tail's proposed equity ratio of 52.7 percent. Otter Tail's proposed capital structure does not raise concerns about an equity ratio that is too low to ensure the financial health of the Company. Therefore, the Department concludes that Otter Tail's proposed capital structure is reasonable.

² Otter Tail's Standard and Poor's credit rating is BBB. The range used by the Department to determine risk-comparability, BBB- to BBB+, is one notch below and one notch above the Company's rating.

B. CONTINGENCIES

1. Common Equity Ratio

Otter Tail requested a contingency range around its equity ratio of plus or minus 10 percent, from a low of 47.4 percent to a high of 58.0 percent. The Department concludes that this range is reasonable because it provides the Company with adequate financial flexibility, keeps Otter Tail on sound financial footing, and allows the Commission sufficient oversight.

2. Short-Term Debt

Otter Tail's proposed capital structure includes a short-term debt ratio of 8.8 percent. The Company, however, also requested that the Commission authorize it to issue short-term debt up to, but not to exceed, 15 percent of its total capitalization.

The Department concludes that the 15 percent cap on short-term debt is reasonable as it would allow the Company needed flexibility in the face of fluctuations in the Company's revenues and expenditures. The 15 percent cap is also consistent with the Commission's Orders in Otter Tail's last three capital structure Dockets.³

3. Total Capitalization

Otter Tail's proposed 2017 capital structure is based on a forecasted total capitalization of \$1,070,931,000, and the Company has requested a total capitalization contingency equal to 10 percent above this forecasted amount (i.e. a contingency of \$107,093,000, for a maximum total capitalization of \$1,178,024,000).

The proposed 10 percent contingency would allow flexibility in the Company's funding of utility construction and unforeseen business or financial conditions that might develop during the year. In addition, the contingency is needed because, during a refinancing, both the old and new debt issues may be outstanding simultaneously for period greater than 60 days. Otter Tail, in particular, has a \$33 million note maturing in August 2017, and plans to refinance it temporarily with short-term debt before combining it with a larger debt financing in 2018.⁴ Therefore, the Department concludes that Otter Tail's requested total capitalization contingency is reasonable.

³ Docket Nos. E017/S-14-381, E017/S-15-411, and E017/S-16-367.

⁴ Petition, Attachment 1.

C. FLEXIBILITY TO ISSUE SECURITIES

Otter Tail stated that it plans to use internally generated cash flows, short-term debt, and equity from OTC to fund its expected 2017 capital expenditure plan, and has requested the authority to issue short-term debt and equity provided that any such issuance would not cause it to exceed the contingencies described above for a period greater than 60 days. Additionally, while Otter Tail does not plan to issue long-term debt during 2016, it has requested the authority to do so, subject to the same limitations.

With respect to potential long-term debt issuances, Otter Tail is likely to issue long-term debt in 2018, possibly while the Commission's Order in this Docket is still in effect, before the Commission issues an Order on Otter Tail's 2018 capital structure. The authority to issue securities, including long-term debt, would allow the Company flexibility to respond to changing market conditions or other unexpected financing needs related to Otter Tail's capital expenditure programs, employee benefit plans, or other financing requirements. The Department therefore recommends that the Commission approve Otter Tail's request. Any securities issuance that would cause the total capitalization or the equity ratio to exceed the contingencies described above for periods exceeding 60 days would first have to be approved by the Commission.

The Departments notes that Otter Tail does not issue common equity. However, it may receive equity contribution from OTC. Attachment No. 10A of the Company's filing shows that the parent company, OTC, expects to contribute \$10.0 million of equity to Otter Tail during 2017. As shown in the Company's Attachment No. 10.

D. OTTER TAIL'S REQUEST FOR VARIANCE

In its Petition, Otter Tail requested a continuation of the variance to Minn. Rule 7825.1000, subp. 6, granted in the Company's 2016 capital structure Docket, to allow the Company to treat borrowings under its MYCF as short-term debt.⁵ As noted by the Company, Minn. Rule 7825.1000, subp. 6 limits the term of such securities to no more than one year, and the MYCF does not conform to this standard.

⁵ Petition, page 10.

Minn. Rule 7829.3200 provides the following three-part test to allow for a variance:

The commission shall grant a variance to its rules when it determines that the following requirements are met:

- A. enforcement of the rule would impose an excessive burden upon the applicant or others affected by the rule;
- B. granting the variance would not adversely affect the public interest; and
- C. granting the variance would not conflict with standards imposed by law.

Otter Tail addressed these requirements on pages 10 and 11 of its Petition. With respect to the first requirement, Otter Tail stated that enforcement of the rule would negate benefits that the Company and its customers derive from direct borrowings under the MYCF for use as short-term debt. The Company stated that without the ability to use its line of credit as short-term debt, an additional burden of increased financing costs and fees resulting from unfavorable reaction by credit rating agencies could be incurred by the Company and its customers.

With respect to the second requirement, the Company stated that granting the requested variance would not adversely affect the public interest but rather would benefit ratepayers by allowing Otter Tail to maintain and secure favorable borrowing terms and liquidity.

With respect to the third requirement, Otter Tail stated that granting the variance would not conflict any standards imposed by law.

After reviewing the Company's discussion of its requested variance to Minn. Rule 7825.1000, subp. 6, the Department concludes that Otter Tail's request meets the requirements of Minn. Rule 7829.3200 and supports the Company's request, for the reasons identified above by the Company. The Department notes that both Minnesota Power and Northern States Power Company received similar variances for multi-year credit agreements in their most recent capital structure dockets.⁶

⁶ Docket Nos. E015/S-17-142 and E,G002/S-16-887.

V. RECOMMENDATIONS

Based on its review and analysis of Otter Tail's 2017 capital structure petition, the Department recommends that the Commission:

1. Approve Otter Tail's requested capital structure; this approval to be in effect until the Commission issues its 2018 capital structure Order.
2. Approve Otter Tail's proposed equity ratio of 52.7 percent and a contingency range of plus or minus 10 percent around the approved equity ratio (i.e. 47.4 percent to 58.0 percent). Otter Tail's equity ratio may not exceed this range for a period greater than 60 days without prior Commission approval.
3. Approve Otter Tail's proposed total capitalization of \$1,070,931,000 and a cap of 10 percent above that amount (i.e. a cap of \$1,178,024,000). Otter Tail's total capitalization may not exceed this cap for a period greater than 60 days without prior Commission approval.
4. Approve Otter Tail's request to issue short-term debt not to exceed 15 percent of its total capitalization (i.e. up to \$160.6 million). Otter Tail's short-term debt may not exceed this 15 percent of its total capitalization for a period greater than 60 days without prior Commission approval.
5. Approve any securities issuances during the period in which the Commission's Order in this Docket is effective that would not result in a capital structure that violates any of the approved contingencies for a period greater than 60 days. Otter Tail may not engage in securities issuances that result in a capital structure that violates any of the approved contingencies for a period greater than 60 days without prior Commission approval.
6. Require Otter Tail to provide, within 20 days after each non-recurring issuance of securities, the following information:
 - a. The specific purposes for the individual issuances;
 - b. The type of issuances;
 - c. The timing of issuances;
 - d. The amounts issuances;
 - e. Issuance costs; and
 - f. Interest rates.

7. Require Otter Tail to provide, in its next capital structure filing, an exhibit showing a general projection of capital needs, projected expenditures, anticipated sources, and anticipated timing, with the understanding that such exhibit is not intended to require dollar-for-dollar spending on the uses identified in the exhibit or to limit issuances to project-specific financing. The exhibit need not list short-term, recurring security issuances.
8. Require Otter Tail to provide in its next annual capital structure filing a schedule comparing its actual capital investments in the past year with the capital investments projected by Otter Tail in its previous capital structure filing.
9. Require Otter Tail to provide in its next annual capital structure filing the Company's investment plan not only for the next year, but for at least the next five years.
10. Approve Otter Tail's request for a variance to allow it to treat any loan under its multi-year credit facility as a short-term debt and require OTP to report on its use of such facilities, including:
 - how often they are used;
 - the amount involved;
 - rates and financing costs; and
 - the intended uses of the financing.
11. Require Otter Tail to file its 2018 capital structure filing by May 1, 2018.

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**DOC Proxy Group for
Proposed Debt and Equity Ratios Based on Otter Tail Power Co.'s S&P Credit Rating of BBB**

Company	Ticker	S&P Debt Rating	2016 Capital Structure Ratios		
			Short-Term Debt	Long-Term Debt	Equity (Preferred & Common)
OTTER TAIL POWER COMPANY - PROPOSED		BBB	8.8%	38.5%	52.7%
<u>Proxy Group</u>					
BLACK HILLS CORP	BKH	BBB	2.0%	65.3%	32.8%
DOMINION RESOURCES INC	D	BBB+	6.3%	64.3%	29.4%
EDISON INTERNATIONAL	EIX	BBB+	4.9%	41.9%	53.2%
EL PASO ELECTRIC CO	EE	BBB	3.4%	52.5%	44.1%
EMPIRE DISTRICT ELECTRIC CO	EDE	BBB	1.5%	51.1%	47.5%
ENTERGY CORP	ETR	BBB+	1.8%	63.1%	35.2%
EXELON CORP	EXC	BBB	2.1%	56.1%	41.8%
FIRSTENERGY CORP	FE	BBB-	9.3%	69.0%	21.7%
GREAT PLAINS ENERGY INC	GXP	BBB+	4.9%	36.0%	59.2%
HAWAIIAN ELECTRIC INDS	HE	BBB-	0.0%	46.3%	53.7%
IDACORP INC	IDA	BBB	0.6%	44.5%	54.9%
OTTER TAIL CORP	OTTR	BBB	3.4%	43.0%	53.5%
PNM RESOURCES INC	PNM	BBB+	6.6%	54.8%	38.6%
PORTLAND GENERAL ELECTRIC CO	POR	BBB	0.0%	50.1%	49.9%
<u>Proxy Group Summary Statistics</u>					
No. of Companies	14				
Minimum			0.0%	36.0%	21.7%
Average			3.3%	52.7%	44.0%
Maximum			9.3%	69.0%	59.2%
Otter Tail Rank Within Proxy Group (1 = highest)			2	14	6

Source: Compustat Research Insight Database