


## Staff Briefing Papers

Meeting Date	September 13, 2018	Agenda Item <b>**2</b>
Company	Otter Tail Power Company (OTP)	
Docket No.	<b>E-017/S-18-313</b> In the Matter of the Petition of Otter Tail Power Company for Approval of 2018 Capital Structure and Permission to Issue Securities	
Issues	<ol style="list-style-type: none"><li>1. Should the Commission approve OTP's 2018 capital structure and grant permission to issue securities?</li><li>2. Should the Commission require OTP to provide additional information in all future capital structure filings?</li></ol>	
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 <b>Relevant Documents</b>	<b>Date</b>
OTP 2018 Capital Structure and Permission to Issue Securities Petition	May 1, 2018
OTP Supplemental Filing	June 6, 2018
Department of Commerce – Comments	June 15, 2018
OTP Reply Comments	July 9, 2018
Department of Commerce – Response Comments	July 31, 2018

The attached materials are work papers of the Commission Staff. They are intended for use by the Public Utilities Commission and are based upon information already in the record unless noted otherwise

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## Statement of the Issues

1. Should the Commission approve OTP's 2018 capital structure and grant permission to issue securities?
2. Should the Commission require OTP to provide additional information in all future capital structure filings?

## Introduction

### OTP's 2018 Capital Structure Filing

On May 1, 2018, Otter Tail Power (OTP) filed its 2018 Capital Structure and Permission to Issue Securities Petition. OTP's 2018 capital structure filing is very similar to its 2017 petition.

In summary, OTP is seeking approval of a common equity ratio of 53.2 percent with a contingency window of plus 10 percent and minus 10 percent (47.9 percent to 58.5 percent). OTP is also seeking approval of a total capitalization of \$1,094,924,000, with a contingency cap of \$109,492,000 (\$1,204,416,000). These parameters will not be exceeded for more than 60 days. OTP is also seeking permission to issue debt securities and to receive equity contribution from Otter Tail Corporation while remaining within the parameters just noted.

On June 6, 2018, OTP filed a supplemental filing. OTP noted that this filing was prompted by questions raised by the Department as to why OTP's Petition did not include information required in Minn. R. 7825.1500<sup>1</sup> and an explanation why the information was deemed to be unnecessary by OTP.

Minn. Rules 7825.1500 pertain to the filing of (1) a copy of the final registration statement and related financial exhibits filed with the Securities and Exchange Commission (SEC) and (2) the terms of any proposals received by OTP for an invitation for the purchase or underwriting of securities, when or as available.

OTP indicated that Minn. R. 7825.1500 does not constitute a filing requirement and that it applies only when the information required therein is available. OTP emphasized that it is a subsidiary of Otter Tail Corporation and, as such, it has not filed any registration statements with the SEC. OTP generally implied that Minn. Rules 7825.1500 is pertinent to its parent company and that OTP does not believe that this rule requires it to submit its parent Company's SEC filings. OTP also indicated that there have been no invitations for public proposals for the purchasing or underwriting of OTP's securities. Notwithstanding its position, OTP included a copy of its parent Company's most recent Form S-3 Registration Statements filed with the SEC in May 2018 (after OTP submitted its Petition to the Minnesota Commission).

### Department of Commerce's Comments

The Department filed its Comments on June 15, 2018.

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<sup>1</sup> The full text of this rule can be found here: <https://www.revisor.mn.gov/rules/7825.1500/>

The Department noted that the OTP had satisfied all of the filing requirements.<sup>2</sup> The Department recommended that the Commission approve OTP's 2018 capital structure and grant permission to OTP to issue debt securities and, receive equity contributions from Otter Tail Corporation, within the parameters of the approved capital structure.

The second part of the Department's comments deals with the Department's recommendation to make certain filing requirements applicable to all future capital structure filings. The Department suggested that certain filing requirements which are issued anew in each annual capital structure order be applicable to all future capital structure filings. The Department specifically identified three such requirements.

In addition, the Department recommended that the Commission require OTP, in all its capital structure filings, to demonstrate, to the extent practicable, that its bond issuances since the date of OTP's previous annual capital structure filing were cost competitive in comparison with "all other utility bond issuances over the same period."

On July 9, 2018, OTP filed Reply Comments. OTP noted that it provided the information required in the Commission's order in the previous year's capital structure docket. Further, OTP agreed to provide general information, or work with the Department in providing the information required, in the Commission's Order in previous capital structure filings. However, concerning the demonstration of the cost competitiveness of bond issuances, OTP remonstrated that comparison with "all other utility bond issuances" may be overly broad and that the comparator group be narrowed to "a representative sample of comparable peer issuances, subject to data availability."

On July 31, 2018, the Department filed Response Comments. The Department agreed with OTP that a more targeted comparison would be useful and suggested that OTP compare its bond issuances with all bond issuances over the same period by other U.S. electric utilities with an investment-grade long-term issuer credit rating from Standard & Poor's BBB- or higher.

## **Issue 1. Should the Commission approve OTP's 2018 capital structure and grant permission to issue securities?**

### **I. Details of OTP's Capital Structure and Permission to Issue Securities Petition**

OTP's capital expenditure plans for 2018 primarily consist of capital expenditures to maintain existing plant in the areas of generation (\$11.4 million), transmission (\$11.5 million), distribution (\$21.8 million), and other routine replacements (\$11.1 million), along with capital expenditures related to OTP's share of the Big Stone Area transmission projects (\$33.7 million) and continuation of the project to upgrade OTP's Customer Information System (\$3.5 million). OTP has also planned capital expenditures for the early stage addition of a new wind generation resource (\$0.8 million) and a new gas plant (\$0.7 million).

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<sup>2</sup> The Department did not raise any further issues with regard to Minn. R. 7825.1500.

OTP proposes the following capital structure as of December 31, 2018:

Table 1 Projected Capital Structure Summary, December 31, 2018		
	Amount (\$ thousands)	Percent
Short Term Debt	0	0
Long Term Debt	\$512,000	46.8%
Common Equity	\$582,924	53.2%
Total Capitalization	\$1,094,924	100.0%

OTP requests approval of a contingency cap of 10-percent above the total capitalization (i.e., a cap of \$1,204,416,000).<sup>3</sup> Similar to the equity ratio, any contemplated securities issuance that may cause total capitalization to exceed the cap for a period to exceed 60 days would have to be approved by the Commission.

While Table 1 above shows the expected capital structure for the year-end 2018, the following Table 2 shows the capital structure ranges requested by OTP:

Table 2 Requested Capitalization Contingency Ranges <sup>4</sup>		
	Minimum	Maximum
Short Term Debt	0%	15%
Long Term Debt	26.5%	52.1%
Common Equity	47.9%	58.5%

OTP requests approval of a contingency window of plus 10 percent and minus 10 percent (47.9 percent to 58.5 percent) around the proposed equity ratio of 53.2 percent (based on the estimated point-in-time equity ratio as of December 31, 2018). Any securities issuance by OTP that results in an equity ratio within this window would fall within this authority.

OTP seeks permission for its equity ratio to fall outside this contingency range for a period of 60 days without Commission approval.

OTP is a wholly owned subsidiary of Otter Tail Corporation and therefore OTP does not issue its own equity securities. OTP receives its equity in the form of equity contributions from Otter Tail Corporation. OTP, however, issues its own debt securities.

<sup>3</sup> Staff notes a rounding discrepancy of \$400.

<sup>4</sup> DOC Comments, June 15, 2018, p. 2. As shown by the Department, the minimum and maximum parameters for long-term debt are implied by OTP's requested parameters for common equity and short-term debt. The minimum proportion of long-term debt is 1 minus the sum of the maximums for common equity and short-term debt ( $1 - 58.5\% - 15.0\% = 26.5\%$ ), and the maximum percentage of long-term debt is 1 minus the sum of the minimums for common equity and short-term debt ( $1 - 47.9\% - 0.0\% = 52.1\%$ ).

OTP requests a contingency cap of 15 percent of capitalization (\$164.2 million) for short-term debt. Short term debt that exceeds the contingency range for a period not exceeding 60 days would be authorized. OTP's existing revolving credit facility allows it to borrow up to \$170 million of short-term unsecured debt subject to the 15 percent cap. OTP requests that it be allowed to issue up to \$170 million, the total amount of its line of credit, in the event of an unanticipated large scale capital project or other unanticipated needs for short term borrowing.

Finally, OTP requests a continuation of variance of Minn. Rules 7825.1000, Subp. 6, so as to allow OTP to treat borrowings under multi-year credit agreement as short term debt for approved capital structure purposes. OTP notes that this variance is needed because Minn. Rule 7825.1000 Subp. 6 limits the maturity date of such securities to no more than one year, and OTP's multi-year credit facility does not conform to this standard. OTP notes that granting the variance would not adversely affect the public interest.

In sum, OTP is seeking approval:

- a. of its proposed 2018 capital structure,
- b. to issue securities evidencing long term debt, including First Mortgage Bonds and other secured or unsecured debt obligations subject to provisions in d., e., and f. following;
- c. to issue short term unsecured debt with a continuation of a variance from Minn. Rules 7825.1000, subp. 6 and also subject to provisions in d. through i. following;
- d. of contingency range for equity ratio of plus or minus 10 percent around the proposed equity ratio of 53.2 percent;
- e. of equity ratios exceeding 58.5 percent or falling below 47.9 percent for a period not exceeding 60 days;
- f. of contingency cap on total capitalization of 10 percent above \$1,094,924,000 (the approved total capitalization) or \$1,204,416,000;
- g. of total capitalization exceeding the cap for a period not exceeding 60 days;
- h. of short-term debt contingency cap based on 15 percent of total capitalization; and
- i. of short term debt exceeding the short term contingency range for a period not exceeding 60 days.

## **II. Department's Comments**

The Department filed its Comments on June 15, 2018.

The Department reviewed OTP's petition and concluded that it complied with all applicable reporting requirements.

The Department recommends approval of OTP's proposed capital structures, the various contingency ranges, and request for permission to issue securities.

In its analysis, the Department noted that OTP's parent, Otter Tail Corp., currently maintains a long-term issuer credit rating of BBB from Standard & Poor's (S&P), one level above the investment-grade minimum of BBB-. The Department recommended approval of the capitalization, equity range, and the 15% cap on short-term debt in light of OTP's avoidance of financial distress and maintenance of good credit rating.

The Department also supports OTP's request for a continuation of a variance of Minn. Rules 7825.1000, subp. 6, and permission to treat borrowing under multi-year credit agreements as short-term debt for approved capital structure purposes.

Finally, the Department recommends approval of OTP's proposal to issue debt securities and receive equity contributions from Otter Tail Corporation, as long as the Company stays within the approved capital structure.

### **III. Commission Options**

The decision alternatives for this issue are listed at the end of the briefing papers under Issue 1.

#### **Issue 2. Should the Commission require OTP to provide additional information in all future capital structure filings?**

##### **I. Introduction**

Attachment 1 to the Department's June 15, 2018 Comments contains a summary of all the filing requirements applicable to OTP. These requirements are dictated by the Commission's Rules and prior Orders.

Whereas the requirements indicated by the Rules are recurring and apply to all prospective capital structure filings, the requirements imposed by the Commission's Orders are generally confined to the "next" annual capital structure filing.

Recently, with regard to utility capital structure filings, the Department has recommended that such filing requirements as are applicable to the "next" capital structure docket be formally made recurring with every future capital structure filing.

##### **II. Requirements Applicable to all Future Filings**

In the instant docket, the Department has recommended that the following three requirements established by the Commission in OTP's previous (i.e., 2017) capital structure docket (E-017/S-17-337) be applicable to all of OTP's future capital structure filings:

**Requirement (1):** In all future capital structure filings, OTP should provide a schedule comparing its actual capital investments in the past year with the capital investments projected by OTP in the preceding year's capital structure filing.

**OTP's Response:** A comparison of actual capital investment in 2017 with that budgeted for 2017 is provided in Attachment 10c of the current filing. To the extent the Department would like OTP to include the preceding year's capital spending data in future filings (in this example 2016 budgeted and actual capital spending would be included with 2017 data), OTP does not object.

**Requirement (2):** In all future capital structure filings, OTP should provide the Company's investment plan for at least the next five years.

**OTP's Response:** This information is provided in Attachment 10b, "Capital Expenditures Projected by Category," included with the instant capital structure filing. In future filings, OTP undertakes to work with the Department to make the attachment more informative and/or respond to information requests concerning this data.

**Requirement (3):** In all future capital structure filings, OTP should report on its use of its multi-year credit facility, including how often the facility was used, the amount involved in any usage, rates and financing costs, and the intended uses of the financing.

**OTP's Response:** This information is provided in Attachment 11, "Report of Use of Multi-Year Credit Facility," except for a report of intended uses of the short-term financing. OTP can provide general information regarding the intended uses of the short-term credit facility in future filings.

In addition to the above 3 requirements, the Department has recommended that the Commission apply the following requirement to all of OTP's future capital structure filings:

**Requirement (4):** In all future capital structure filings, OTP should provide, to the extent practicable, evidence to demonstrate that any bond issuances since the date of OTP's last annual capital structure filing were cost competitive, with the analysis including, at a minimum, a detailed comparison of OTP's bond issuances to all other utility bond issuances over the same period.

**OTP's Response:** OTP does not object to providing information in future filings reasonably demonstrating the cost competitiveness of any bond issuances since the date of OTP's last annual capital structure filing. OTP expressed its concern that the scope of the Department's requested analysis may be too broad and proposed that a more helpful approach would be an analysis based on a representative sample of comparable peer issuances, subject to data availability.

**Department's Response:** In its July 31, 2018 Response Comments,<sup>5</sup> the Department modified its recommended requirement – "to the extent practicable, evidence to demonstrate that any bond issuances since the date of OTP's last annual capital structure filing were cost competitive, with the analysis including, at a minimum, a detailed comparison of OTP's bond issuances to all bond issuances over the same period by other U.S. electric utilities with an investment-grade long-term issuer credit rating from Standard & Poor's BBB- or higher."<sup>[BH1]</sup>

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<sup>5</sup> In its July 31, 2018 Response Comments, the Department opposed OTP's selection of "a representative sample of comparable peer issuances." The Department stated its concern that use of "a representative sample" would allow OTP to alter the comparison to its own benefit. However, the Department concurred that a more targeted comparison would be useful, relative to the Department's original recommendation of including all other utility bond issuances.

#### IV. Staff Comments

Regarding Requirement (4) above, the Department's recommendation is reasonable in light of OTP's current long-term issuer credit rating of BBB from Standard & Poor's; it is also known that Otter Tail Corporation's long-term issuer rating from S&P is BBB.<sup>6</sup>

Inasmuch as the requirement is prefaced with the optional clause – “to the extent practicable” – the requirement is not mandatory and the pressure of compliance is correspondingly diminished.

Staff noticed that there is one other requirement in the Commission's September 1, 2017 Order in E-017/S-17-337 which the Department has not asked to be made permanent:

“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.”

In OTP's instant capital structure filing, this requirement is addressed in Attachment No. 10b, “Capital Expenditures Projected by Category.”

The Commission may wish to inquire of the Department if this requirement, included as item 6, under Option A, in Issue 2 (page 9) following, should also be made permanent.

#### V. Commission Options

The decision alternatives for this issue are listed at the end of the briefing papers under Issue 2.

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<sup>6</sup> The Department's June 15, 2018, p. 2.



## Commission Decision Alternatives

### **Issue 1: Should the Commission approve OTP's 2018 capital structure and grant permission to issue securities?**

Option A. Department and OTP: Approve OTP's proposed 2018 capital structure and grant permission to issue securities; and

1. approve a common-equity range of 47.9% to 58.5%, not to be exceeded for more than 60 days without Commission approval;
2. approve a short-term debt range up to 15%, not to be exceeded for more than 60 days without Commission approval;
3. approve a total maximum capitalization of \$1,204,416,000, not to be exceeded for more than 60 days without Commission approval;
4. continue to vary Minnesota Rules 7825.1000, subpart 6, to allow OTP to treat borrowings under its multi-year credit agreement as short-term debt for approved capital-structure purposes;
5. within the approved capital structure, allow OTP to issue debt and receive equity contributions from its parent company, Otter Tail Corporation;
6. make the above approvals effective until the Commission issues its next capital structure Order; and
7. require OTP to make its 2019 capital structure filing on May 1, 2019.<sup>7</sup>

Option B. Other action by the Commission

### **Issue 2: Should the Commission require OTP to provide additional information in all future capital structure filings?**

Option A. Direct OTP to provide the following information on all future capital structure filings:

1. a schedule comparing its actual capital investments in the past year with the capital investments projected by OTP in the preceding year's capital structure filing (Department and OTP);
2. OTP's investment plan for at least the next five years (Department and OTP);
3. a report on the OTP's use of its multi-year credit facility, including how often the facility was used, the amount involved in any usage, rates and financing costs, and the intended uses of the financing (Department and OTP);
4. to the extent practicable, evidence to demonstrate that any bond issuances since the date of OTP's last annual capital structure filing were cost

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<sup>7</sup> Department of Commerce Comments, June 15, 2018, p. 6. Somehow, this provision is not listed in the Department's final summary of recommendations (Response Comments, July 31, 2018, pp. 2-3).

competitive, with the analysis including, at a minimum, a detailed comparison of OTP's bond issuances to all bond issuances over the same period by other U.S. electric utilities with an investment-grade long-term issuer credit rating from Standard & Poor's BBB- or higher (Department);

or,

5. to the extent practicable, provide information in all future capital structure filings reasonably demonstrating the cost competitiveness of any bond issuances since the date of OTP's last annual capital structure filing by comparing OTP's bond issuances with a representative sample of comparable peer issuances, subject to data availability (OTP); and
6. 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 (Staff).

Option B. Other action by the Commission