

May 30, 2019

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. E015/S-19-299

Dear Mr. Wolf:

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

Petition of Otter Tail Power Company for Approval of 2019 Capital Structure and
Permission to Issue Securities.

The petition was filed on May 1, 2019 by:

Mr. Andrew Miller
Vice President, Financial Planning and Treasurer
Otter Tail Power Company
215 South Cascade Street
Fergus Falls, MN 56538

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

Sincerely,

/s/ JOHN KUNDERT
Financial Analyst

JK/ja
Attachment



Before the Minnesota Public Utilities Commission

Comments of the Minnesota Department of Commerce Division of Energy Resources

Docket No. E015/S-19-299

I. SUMMARY OF OTTER TAIL'S PROPOSAL

On May 1, 2019, Otter Tail Power (OTP or the Company) petitioned the Minnesota Public Utilities Commission (Commission) for approval of OTP's 2019 proposed capital structure (Petition). More specifically, OTP is seeking approval of:

- (1) a common equity ratio of 51.1 percent with a contingency of plus or minus 10 percent (i.e., 46.0 percent to 56.2 percent);
- (2) its proposed 2019 capital structure and a total capitalization of \$1,210,275,000 with a contingency cap of \$121,027,000 (total of \$1,331,302,000);
- (3) issuance of securities with the provision that no issuance would result in the Company exceeding the contingencies described in its filing for more than 60 days, without prior Commission approval;
- (4) the ability to issue short-term debt up to \$170,000,000 (13 percent of total capitalization)
- (5) a variance of Minn. Rules 7825.1000, subp. 6 to allow the Company to treat borrowing under multi-year credit agreements as short-term debt.

OTP requests approval of its estimated consolidated capital structure and its proposed issuance of securities from the date of issuance of a Commission Order approving the instant Petition through the latter of (i) May 1, 2020 or (ii) the date at which a subsequent capital structure Order is issued.

II. DETAILS OF OTP'S REQUEST

OTP's actual consolidated capital structures (in thousands of dollars) for July 31, 2018, December 31, 2018, and projected December 31, 2019 are presented below:

OTTER TAIL POWER COMPANY CAPITAL STRUCTURE SUMMARY¹
(\$ in Thousands)

The following is a summary of OTP's actual capitalization and short-term borrowing at July 31, 2018 and December 31, 2018 and as projected at December 31, 2019:

	July 31, 2018		Dec. 31, 2018		Dec. 31, 2019	
	(Actual)		(Actual)		"Projected" (1)	
Short-Term Debt	\$	3,082	0.3%	\$	9,384	0.8%
Current Maturities of LTD		-	0.0%		-	0.0%
Long-Term Debt Net		512,000	46.5%		512,000	46.0%
Preferred Shares		-	0.0%		-	0.0%
Common Share Equity		585,002	53.2%		591,073	53.1%
Total Capitalization	\$	1,100,084	100%	\$	1,112,457	100.0%
					\$ 1,210,275	100.0%

(1) The "Projected" column reflects the Company's best estimate of the proposed capital structure as of December 31, 2019.

Note: These ratios are based on a point in time – December 31, 2019 -- and do not reflect 13-month averages. To maintain consistency with previous filings, long-term debt reflects debt outstanding at year-end 2019 and is not netted with any outstanding balance from unamortized expenses associated with issuing debt or any gain or loss on reacquired debt. Using this projected capital structure for 2019 would produce a 13-month average equity ratio of 52.4% and a 13-month average debt ratio of 47.6% (3.5% short term and 44.1% long term).

OTP's proposed capital structure (in thousands of dollars) for 2019 is presented below:

2019
Proposed Capital Structure
(Thousand dollars)

	<u>Amount</u>	<u>Percentage</u>
Long-Term Debt	\$512,000	42.3%
Short-Term Debt	\$79,789	6.6%
Common Equity	\$618,486	51.1%
Total Capitalization	\$1,210,275	100.00%
Contingency	\$121,027	
Total	\$1,331,302	

¹ Information taken from Attachment 1 of the Petition.

OTP estimates the following issuances of securities (in thousands of dollars):

	January – December 2019
	Estimated Amounts
	<u>To be Issued</u>
Long-Term Debt	\$0
Short-Term Debt	\$79,789 ²
Common Equity	\$10,250

OTP may issue short-term debt during the authorization period as needed primarily to fund maturing long-term debt or for short-term bridge financing. Combined corporate and subsidiary short-term obligations are not expected to exceed \$170 million at any one time during the authorization period. OTP does not request any short-term debt contingency amount.

The Company requests approval of the following contingencies and securities issuances during the authorization period:

- a range of 10 percent below and 10 percent above the 2019 common equity ratio of 51.1 percent (*i.e.*, a range of 46.00 percent to 56.21 percent);
- any securities issuance that results in an equity ratio within that range, or that would not result in an equity ratio outside this range for more than 60 days;
- a cap of \$121,027,000 over OTP's total capitalization of \$1,210,275,000 (*i.e.*, a total capitalization of \$1,331,302,000); and
- any securities issuance that results in total capitalization below the cap (*i.e.*, below \$1,331,302,000), or that would not result in total capitalization above the cap for more than 60 days.

In addition, OTP proposes to seek approval from the Commission for any securities issuance as soon as the Company has reason to believe that any such issuance would cause the common equity ratio or total consolidated capitalization to fall outside the approved contingency ranges for more than 60 days.

² OTP may issue short-term debt at any time during the authorization period, not to exceed \$170 million capitalization.

III. DEPARTMENT ANALYSIS

The Department's review indicates that OTP has provided all the information required by Minn. Rules 7825.1000 - 7825.1500.

In its analysis below, the Department discusses the reasonableness of both OTP's capital structure and OTP's request for securities issuance.

A. CAPITAL STRUCTURE

To check the reasonableness of OTP's 2019 capital structure, the Department compared the equity ratio of OTP's proposed capital structure with the average equity ratio of electric utilities that are risk-comparable to OTP. The 2018 average equity ratio for publicly traded electric utilities with bond ratings from BBB - to A- (OTP's bond rating is BBB) was 43.34 percent. The group's 2018 average long-term debt ratio was 51.34 percent.³ The Department notes that OTP's proposed equity ratio of 51.1 percent is significantly higher than the group's average equity ratio, and that OTP's debt ratio is lower than the group's average debt ratio. Therefore, OTP's consolidated capital structure does not raise concerns about an equity ratio that is too low, which could have negative effects on the Company between rate cases.

In OTP's most recent capital structure petition (Docket No. E017/S-18-313), the Commission approved a 10 percent contingency range around its approved equity ratio. The Department concludes that a 10 percent contingency range is reasonable because it would allow the Company the needed financial flexibility, but also provides sufficient regulatory oversight.

1. Total Capitalization and Issuance of Securities

OTP's best estimate of its issuance of securities in 2019 is provided below:

	Estimated Amounts
	<u>To be Issued</u>
Long-Term Debt	\$0
Short-Term Debt	as needed ⁴
Common Equity	\$10,250,000

³ See Attachment 1.

⁴ See footnote 1.

As indicated above, the Company requests approval for total capitalization not to exceed \$1,210,275,000. This total capitalization does not include the contingency amount of \$121,027,000.

Pages 5 through 6 of the Company's Petition discuss in detail the need for the various securities issuances, to provide for funding for existing operations. In particular, OTP anticipates capital expenditures of about \$183,313,590. Based on its expected capital expenditures, the Department recommends that the Commission approve OTP's request for the \$121,027,000 contingency cap on OTP's total capitalization (about 10 percent of total capitalization). The Department also concludes that the issuance of the aforementioned securities is appropriate and recommends that the Commission approve any issuance of securities during the authorization period that would not result in an equity ratio outside the proposed range or total capitalization exceeding the proposed cap for more than 60 days.

The Department notes that any property acquisitions by OTP must follow the requirements of Minnesota Statutes and Rules; the Commission's approval of the Company's capital structure petition does not, in any way, suggest that the Commission would approve any petition regarding property acquisitions or affiliated interests. Further, it should be clear that no utility assets may be pledged to finance non-regulated activities.

2. Equity Ratio

The Company requests a contingency range of plus or minus 10 percent around OTP's proposed 51.1 percent equity ratio (*i.e.*, 46.0 percent to 56.2 percent). The Department recognizes OTP's need for financial flexibility to respond to unexpected changes in its financial and economic environment. However, this need for flexibility must be balanced against appropriate regulatory oversight. In its most recent Order regarding OTP's capital structure (Docket No. E017/S-18-313), the Commission allowed OTP a contingency range of plus/minus 10 percent around its approved equity ratio. This contingency range is the same as the one requested by the Company in the instant Petition. The Department concludes that a 10 percent range, as proposed by OTP, would provide OTP with sufficient financial flexibility, while at the same time allowing the Commission sufficient regulatory oversight of the Company's capital structure. Therefore, based on its analysis and the Commission's Order in Docket No. E017/S-18-313 the Department concludes that OTP's proposed common equity contingency is reasonable.

3. Short-Term Debt

The Company requests flexibility to issue short-term debt not to exceed \$170 million any time during the authorization period. This cap includes any short-term debt that may be issued under OTP's Credit Facility provisions. The Department concludes that the \$170 million (about 13 percent of total capitalization) cap is reasonable because it would allow the Company the

needed flexibility to meet the Company's short-term fluctuations in its revenues and expenditures. The Department also notes that the Commission allowed the Company a similar cap on short-term debt in its previous Capital Structure Order (Docket No. E017/S-18-313). The Department discusses the Company's request for a variance regarding its credit facility later in Section IV below.

C. ADDITIONAL REPORTING REQUIREMENTS

On October 18, 2018, the Commission issued an Order in Docket No. E017/S-18-313. Point 8 of the Commission Order:

Directed OTP, consistent with the agreement reached at the Commission meeting, to provide the following information on all future capital structure filings:

- A. 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.
- B. OTP's investment plan for at least the next five years.
- C. 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.
- D. To the extent practicable, 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 of BBB up to A-.

For the sake of clarity, the Department summarizes the requirements of the above-cited Commission Order with a prior general Order on May 12, 2009 in E,G999/CI-08-1416, which explained further how these reporting requirements are to be used:

- 1. OTP must provide, in its 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 precision 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.
- 2. OTP must provide, in its next annual capital structure filings, 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.

3. OTP must provide in its 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.
4. OTP must provide in its annual capital structure filing the Company's investment plans not only for the next year, but for at least the next five years.

The Department discusses these reporting requirements below.

a. Projected Capital Needs and Anticipated Resources (Point 1 above)

Exhibit 10a of OTP's Petition provides the projected sources and uses of funds for the period 2019. Based on its review of the Company's Exhibit 10.a, the Department concludes that the Petition complies with the Commission's requirement no. 1 above.

b. Actual Uses and Actual Issuances (Point 2 above)

Exhibit 10a of OTP's filing provides information regarding issuances of securities during 2018. It shows that OTP issued \$100,000,000 of long-term securities in 2018. The Company's Exhibit 10c provides the appropriate information regarding the projected and actual 2018 uses of funds. It shows that OTP's actual expenditure of \$92,475,000 in 2018 was \$2,087,000 less than its forecasted expenditure of \$94,562,000. OTP provides explanation of the discrepancy in its attachment 10c. The Department finds OTP's explanation to be reasonable. Therefore, the Department concludes that OTP's Petition complies with the Commission's requirement no. 2 above.

c. Comparison of Actual and Projected Capital Investment (Point 3 above)

OTP's Exhibit 10c, page 1, provides the required information. As noted previously, OTP's actual capital expenditure in 2018 was \$92,475,000. Thus, actual expenditures in 2018 were about 98 percent of the projected capital expenditure. This difference is explained in footnotes No. 1 through 6 of Attachment 10c. The Department concludes that OTP's explanation is generally reasonable.

Based on the above analysis, the Department concludes that OTP's Petition complies with the Commission's requirement No. 3 above.

d. Five-Year Investment Plan (Point 4 above)

OTP is required to submit its investment plan for, at least, the next five years. Exhibit 10b of the Company's Petition provides its investment plan for the period 2019 through 2023. Based

on its review of the Company's Exhibit 10b, the Department concludes that OTP's Petition complies with the Commission's requirement no. 4 above.

IV. CONTINUED VARIANCE OF MINNESOTA RULES 7825.1000, SUBPART 6

OTP requests that the Commission continue to vary Minnesota Rules 7825.1000, subpart 6, to allow OTP to treat borrowing under its multi-year credit agreement as short-term debt for approved capital structure purposes. Because Minn. Rules part 7825.1000, subpart 6, defines short-term securities as those with a date of maturity of no more than one year, to classify multi-year credit agreements as short-term debt, OTP needs the Commission to make the requested variance.

To vary its rules, the Commission must determine, per Minn. Rules 7829.3200, subp. 1, that the variance satisfies three requirements:

- 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.

The Department agrees with OTP that the Company's requested variance satisfy the three requirements (Petition at pages 10 and 11). OTP's current multi-year credit agreement resembles traditional short-term debt instruments and classifying multi-year credit agreements as long-term debt could cause credit-rating agencies to react unfavorably, thus imposing an excessive burden on OTP and potentially hurting ratepayers. In addition, classifying multi-year credit agreements as short-term debt would not conflict with any standards imposed by law.

Therefore, the Department recommends that the commission continue to vary Minn. Rules 7825.1000, subp. 6, and allow OTP to treat borrowing under multi-year credit agreements as short-term debt for approved capital structure purposes.

The Department notes that in 2018 the Company borrowed money from its credit facility in January through July and in December. The average interest rate for the 2018 borrowing was 3.15 percent. OTP also paid amortization issuance cost of 0.647 percent. Adding this charge to the borrowing cost of 3.15 percent result in total interest rate of 3.79 percent.

V. COMPETITIVENESS OF DEBT INSURANCES

The Commission Order dated October 18, 2018 required OTP, to the extent practical, that any bond issuances since the date of OTP's last annual capital structure filing were cost-competitive. The requirement analysis must include a detailed comparison of OTP's bond

issuances to all bond issuances over the same time period by other U.S. electric utilities with long-term Standard and Poor (S&P) debt rating of BBB- through A-. OTP provides this information in its Attachment 12 and Attachment 12.a. OTP's S&P long-term debt rating is BBB. Over the period August 2017 – January 2018, the average spread over the 30-year treasury bonds for BBB rated utilities was 133 basis points. OTP issued \$100 million long-term debt on November 17, 2017, with an interest rate of 4.07 percent, a 120 basis point above the 30-year treasury bond. This spread is 13 basis points below the average spread for BBB rated electric utilities.

Therefore, the Department concludes that OTP's long-term debt borrowing was competitive and therefore, reasonable.

VI. DEPARTMENT RECOMMENDATIONS

The Department's recommendations are as follows:

A. *RECOMMENDATIONS REGARDING SECURITIES ISSUANCES AND CAPITAL STRUCTURE*

1. Approve OTP's 2019 proposed capital structure. This approval will remain effective until the latter of May 1, 2020 or the date at which the Commission issues a new capital structure Order;
2. Approve OTP's equity ratio contingency of plus/minus 10 percent around its 2019 proposed equity ratio. Equity ratios outside this range may not exceed a period of 60 days without Commission approval;
3. Approve OTP's total capitalization contingency of \$121, 027,000 above its 2019 total capitalization. OTP may not exceed its total capitalization including the requested contingency of \$121, 027,000 for a period longer than 60 days without prior Commission approval;
4. Allow OTP to issue any securities in 2019 that would not result in an equity ratio outside the proposed range or a total capitalization exceeding its proposed cap for more than 60 days;
5. Require OTP to obtain prior approval for the issuance of any securities in 2019 that would result in an equity ratio outside the approved range or a total capitalization exceeding its approved cap for more than 60 days.
6. Require OTP 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 of issuances;
 - e. Issuance costs (for common equity issuances, include price per share), and
 - f. Interest rates.
7. Require 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 information on the uses identified in the exhibit or to limit the issuances to project-specific financing. The exhibit need not list short-term security issuances.
8. Require OTP to provide, in its next annual capital structure filing, 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 security issuances.
9. Require 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.
10. Require 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.
11. Approve 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.
12. Require OTP to file its request for approval for its 2020 securities issuances no later than May 1, 2020.
13. Require OTP, in its next securities issuance filing to show its competitiveness of debt issuances, using analysis similar to its analysis in attachment 12 of the instant Petition.
14. Clarify that approval of securities issuance and the resulting capital structure, within this proceeding, is not a determination of the appropriate capital structure for ratemaking purposes.

/ja

Company	Ticker	SIC Code	Credit Rating	Total Capitalization	Short-Term Debt Ratio	Long-Term Debt Ratio	Common Equity Ratio
ALLETE, Inc.	ALE	4931	BBB+	3,642	0.00%	40.80%	59.20%
Alliant Energy Corporation	LNT	4931	A-	10,730	4.11%	51.29%	42.74%
Ameren Corporation	AEE	4931	BBB+	16,809	3.55%	50.21%	45.40%
Avista Corporation	AVA	4931	BBB	3,914	4.85%	49.82%	45.31%
CenterPoint Energy, Inc.	CNP	4931	BBB+	17,222	0.00%	53.21%	36.69%
CMS Energy Corporation	CMS	4931	BBB+	16,569	0.59%	70.49%	28.70%
Consolidated Edison, Inc.	ED	4931	A-	37,550	6.83%	48.32%	44.54%
DTE Energy Company	DTE	4931	BBB+	24,959	2.44%	54.62%	41.02%
Duke Energy Corporation	DUK	4931	A-	101,773	3.35%	53.58%	43.05%
Evergy, Inc.	EVRG	4931	A-	18,523	5.96%	40.10%	54.14%
NorthWestern Corporation	NWE	4931	BBB	4,067	0.00%	52.24%	47.76%
OGE Energy Corp.	OGE	4931	BBB+	7,152	0.00%	44.00%	56.00%
Public Service Enterprise Group Inc	PEG	4931	BBB+	29,855	3.40%	48.44%	48.16%
Sempra Energy	SRE	4931	BBB+	44,798	4.64%	52.39%	33.22%
Unitil Corporation	UTL	4931	BBB+	846	9.79%	48.67%	41.52%
WEC Energy Group, Inc.	WEC	4931	A-	21,644	6.65%	47.87%	45.23%
Xcel Energy Inc.	XEL	4931	A-	29,469	3.52%	55.00%	41.47%
Average					3.72%	51.34%	43.34%
DT.DEV					2.84%	6.73%	7.67%