Staff Briefing Papers

Meeting Date	April 9, 2020		Agenda Item ***2**
Company	Northern States Power Company, doing business as Xcel Energy		
Docket No.	**E, G-002/S-19-662** In the Matter of the Petition of Northern States Power Company for Approval of its 2020 Capital Structure and Permission to Issue Securities		
Issue	Should the Commission approve Northern States Power Company's proposed 2020 capital structure and grant permission to issue long-term and short-term securities?		
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✓ **Relevant Documents**	**Date**
NSP-MN - 2020 Capital Structure Petition	October 25, 2019
Department of Commerce – Comments	February 10, 2020
NSP-MN - Reply Comments	February 20, 2020

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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I. Statement of the Issue

Should the Commission approve Northern States Power Company's proposed 2020 capital structure and grant permission to issue long-term and short-term securities?

II. Summary of Northern State Power Company-Minnesota's 2020 Capital Structure Initial Filing

On October 25, 2019, Northern States Power Company, doing business as Xcel Energy (Xcel, NSP-MN, or the Company) filed a petition seeking approval of its proposed 2020 capital structure, as well as permission to issue securities within the scope of the proposed capital structure, plus contingencies.

In particular, NSP-MN is seeking approval of its proposed 2020 capital structure with the following features:

- Total capitalization of $13.2 billion, including a contingency of $596 million;
- A consolidated equity ratio of 52.3 percent with a contingency range of ±10 percent (i.e., a range of 47.07 to 57.53 percent equity);
- The ability to issue short-term debt not to exceed 15 percent of total capitalization;
- Continuation of the variance permitting NSP-MN to enter into and use multi-year credit agreements and issue associated notes, and to consider any direct borrowings as short-term debt for approved capital structure purposes;
- Flexibility to issue securities provided that the Company remains within the contingency ranges or does not exceed them for more than 60 days;
- Continued flexibility to issue long-term debt, provided NSP-MN remains within the limits approved for the short-term debt and equity ratios, as well as within the total capitalization limit;
- Flexibility to use risk management instruments that qualify for hedge accounting treatment;
- Approval to use discretion to enter into financings to replace outstanding long-term debt instruments with less expensive securities after considering the debt issuance expenses and amortization of redemption premiums and expenses, and to enter into tax-exempt financings if funds are available for construction programs; and
- Approval of the 2020 capital structure by March 1, 2020 and is effective until the Commission issues a 2021 capital structure Order.

The Table 1 below provides a comparison of NSP-MN's actual capital structure as of mid-year 2019 and the proposed year-end 2020 capital structure:

Table 1 NSP-MN's Actual and Proposed Capital Structure Summary				
	Actual June 30, 2019		Proposed December 31, 2020	
	Amount ($ million)	Percent	Amount ($ million)	Percent
Short Term Debt	$244	2.2%	$233	1.8%
Long Term Debt	$4,939	45.1%	$5,774	45.8%
Common Equity	$5,768	52.7%	$6,597	52.3%
Total Capitalization (excluding contingency)	$10,951	100.0%	$12,604	100.0%
Contingency			$596	4.7%
Total Capitalization w/ Contingency			$13,200	104.7%

Source: NSP-MN Initial Filing, Attachment B.

As can be seen in Table 1, NSP-MN proposes an increase in total capitalization of approximately $1.7 billion, from $10.9 billion to $12.6 billion, or roughly 15 percent, over the 18 months ending December 31, 2020. The changes, over the same period, in the equity and debt ratios are small.

NSP-MN's projected year-end 2020 capital structure includes up to $550 million of debt issuance and equity infusions of approximately $358 million in 2020.

NSP-MN's requested capitalization of $13.2 billion, including a contingency of $596 million, reflects increased spending for utility construction and infrastructure development during 2020. NSP-MN's 2020 capital expenditure forecast is $2.0 billion, of which approximately $1.1 billion is for wind projects approved in Docket Nos. E002/M-16-777 and E002/M-17-694. In addition to the capital expenditure program, NSP-MN plans to issue short-term debt to provide funds for its utility operations, investments in the utility money pool, and loans to its wholly-owned subsidiary NSP Nuclear Corporation.

According to NSP-MN, the contingency of $596 million would allow the Company necessary flexibility in the funding of utility construction projects and the ability to address unforeseen business or financial conditions that might develop during the year. In addition, NSP-MN notes that the contingency is needed because during refinancing, both the new and old debt issues may be outstanding temporarily beyond the 60-day window that the Company is normally provided.

The Table 2 below shows the capital structure ranges requested by NSP-MN:

Table 2 Requested Capitalization Contingency Ranges (as % of total capitalization)		
	Minimum	Maximum
Short Term Debt	0%	15%
Long Term Debt	Consistent w/ the limits on short-term debt and equity ratios, as well as within the total capitalization limit*	
Common Equity	47.07%	57.53%

* NSP-MN's forecasted year-end 2020 long-term debt ratio is 45.8 percent.

> As the Department points out, NSP-MN has not proposed a specific long-term debt ratio contingency range, but rather proposed to effectively allow its equity and short-term debt contingency ranges to limit its long-term debt ratio. If NSP-MN reaches its maximum proposed equity and short-term debt ratios, (57.53 percent and 15.00 percent, respectively), it will have a long-term debt ratio of 27.47 percent. If it reaches its minimum equity and short-term debt ratios (47.07 percent and zero, respectively) it will have a long-term debt ratio of 52.93 percent.

NSP-MN requests approval of a contingency window of plus 10 percent and minus 10 percent (47.9 percent to 58.5 percent) around the proposed year-end 2020 equity ratio of 52.3 percent. Any securities issuance by NSP-MN that results in an equity ratio within this window would fall within this authority.

NSP-MN is also seeking permission for its equity ratio to fall outside this contingency range for a period of 60 days without Commission approval.

At pages 8-9 and 12-19 of its initial filing, NSP-MN demonstrated its compliance with the filing requirements in Commission Rules and relevant prior Commission Orders.

III. Department's Comments

A. Filing Requirements

The Department verified that NSP-MN has generally complied with the filing requirements established in statutes, rules, and prior Commission orders, with "one minor exception." This exception pertains to the requirement established in the Commission's January 13, 2003 order, in Docket No. E,G-002/S-02-1907, ORDER APPROVING CAPITAL STRUCTURE WITH LIMITATIONS. This order requires NSM-MN to "address, as part of an annual capital structure or securities issuance filings, the appropriate cost of capital to apply to filings for the next 12 months."[1] NSP-MN indicated, in the instant filing, that it:

> . . . proposes to use the last Commission-approved cost of capital for 2020 of 7.08 percent (6.43 percent after-tax) from the company's last electric rate case, Docket No. E002/GR-15-826.[2]

The Commission's June 12, 2017 Findings of Fact, Conclusions, and Order (p. 11) in that multi-year rate case docket approved the following rates of return for Xcel for 2019:

2019			
	Rate	Ratio	Weighted Cost
Short-Term Debt	4.31%	1.69%	0.07%
Long-Term Debt	4.75%	45.81%	2.18%
Common Equity	9.20%	52.50%	4.83%
Total			7.08%

The Department noted that in a more recent docket, E-002/M-17-797 (Transmission Cost Recovery Rider Revenue Requirements docket), the Commission approved a return on equity of 9.06 percent (down from a return on equity of 10.0 percent proposed by Xcel to calculate the revenue requirements) for the Company.

When this 9.06 percent return on equity is combined with the return on debt authorized in the Company's 2015 rate case,[3] the overall rate of return works out to 7.01 percent, as shown below:

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[1] The requirement to address the appropriate cost of capital to apply to filings "for the next 12 months" was first established in Docket E,G-002/CI-02-1346, "In the Matter of an Inquiry Into Possible Effects of Financial Difficulties at NRG and Xcel on NSP and its Customers and Potential Mitigation Measures." This requirement was re-incorporated into the Commission's order in Xcel's capital structure docket, E,G-002/S-02-1907.

[2] Xcel noted that the commission-approved cost of capital from the Company's last natural gas rate case is 8.27 percent (7.42 percent after-tax), Docket No. G002/GR-09-1153.

[3] The capital structure also remains the same as in the 2015 rate case.

	Rate	Ratio	Weighted Cost
Short-Term Debt	4.31%	1.69%	0.07%
Long-Term Debt	4.75%	45.81%	2.18%
Common Equity	9.06%	52.50%	4.76%
Total			7.01%

B. Department Analysis

Capital Structure

The Department examined the reasonableness of NSP-MN's proposed capital structure by comparing it to the capital structures of other electric utilities that are risk-comparable to NSP-MN, as measured by their credit ratings (Department Attachment 3 of the Department's Comments). The equity ratios of comparable electric utilities range from 25.62 percent to 69.29 percent, with an average of 43.51 percent. NSP-MN's proposed equity ratio of 52.3 percent is higher than the average, but well within the range of comparable electric utilities, as are the Company's proposed debt ratios. NSP-MN's higher-than-average equity ratio allows the Company to issue long-term debt at lower interest rates. Additionally, between rate cases the Company has an incentive to have an equity ratio that minimizes its overall total capital cost. For these reasons, the Department concludes that the Company's proposed capital structure is reasonable for purposes of this filing.

Total Capitalization

Regarding the total capitalization of $13.2 billion, including a contingency of $596 million, the Department noted that the contingency would allow adequate financial flexibility to the Company to deal with unexpected financing needs while also providing the Commission with sufficient oversight of its total capitalization. Further, if the Company exercises its ability to increase its total capitalization based on its approved contingency, it would still have to demonstrate to the Commission that its actions were prudent and reasonable before it would be allowed to recover any associated costs. For these reasons, the Department concludes that NSP-MN's proposed capitalization contingency is reasonable and recommends that the Commission approve it.

Equity Ratio Contingency Range

The Department noted that the plus and minus 10 percent range has been in place for over a decade and appears to have worked well during that time. Therefore, the range has historically served its purpose of providing NSP-MN with adequate short-term financial flexibility while not subjecting ratepayers to undue risk. The Department added that it saw no reason to oppose the proposed range as NSP-MN has maintained an actual equity ratio within the midpoint of this range.

Short-Term Debt Ratio Contingency Range

The Department indicated that this range too has been in effect for over a decade and has historically worked to serve its purpose of providing NSP-MN with adequate short-term financial flexibility while not unduly risking harm to ratepayers. Because NSP-MN has managed its capital structure such that its short-term debt ratio is generally significantly lower than 15 percent, and the Company continues to be rated as investment grade, the Department sees no reason for a change in course.

Long-Term Debt Contingency
The Department observed that the Company did not propose a specific long-term debt ratio contingency range, but rather proposed to allow its equity and short-term debt contingency ranges to limit its long-term debt ratio. Because this system has been in place for over a decade and appears to have worked, the Department recommends no change.
Regarding NSP-MN's requested flexibility to issue securities provided that the Company remains within the contingency ranges, or does not exceed them for more than 60 days, the Department recommends that the Commission approve NSP-MN's request as modified to require preapproval to exceed the 60-day grace period. See the Department's recommendation #2.

Regarding NSP-MN's continuing variance from Minn. R. 7825.1000, subp. 6, for authority to treat direct borrowings under its multi-year credit facility as short-term debt, the Department recommends the Commission grant Xcel's request and continue to vary Minn. Rules 7825.1000, subp. 6, and allow NSP-MN to treat borrowing under multi-year credit agreements as short-term debt. The Department also notes that the Commission has granted the same variance and allowance for all NSP-MN's capital structure filings since 2005.

The Department agrees with NSP-MN that risk-management instruments such as interest rate swaps can benefit ratepayers as long as NSP-MN follows prudent corporate guidelines in its usage of such instruments and allows the Commission sufficient oversight. The Department noted that the Company is already required to report on its use of risk-management instruments per the Commission's 17-767 Order. The Department recommends that the Commission continue to allow NSP-MN to use risk-management instruments that qualify for hedge accounting treatment under Accounting Standard Codification No. 815 (See the Department's recommendation #3).

NSP-MN specifically requested Commission approval to have discretion to enter into financings to replace outstanding long-term debt instruments with less expensive securities after considering the debt issuance expenses and amortization of redemption premiums, and to enter into tax-exempt financings for pollution control construction programs. As both types of financings would reduce costs to ratepayers, the Department recommends that the Commission grant NSP-MN's request. However, to ensure adequate oversight, the Department also recommends that the Commission require NSP-MN's next capital structure filing to report on such financings and their impact on ratepayers.

C. Department Recommendation

The Department recommended that the Commission:

1. Approve NSP-MN's requested 2020 capital structure and contingencies, effective until the Commission issues an order on NSP-MN's 2021 capital structure;

2. Allow NSP-MN to issue securities provided that the Company remains within the approved contingencies or does not go outside the approved contingencies for more than 60 days without the Commission's preapproval;

3. Continue to allow NSP-MN to use risk-management instruments that qualify for hedge accounting treatment under Accounting Standard Codification No. 815;

4. Continue to allow NSP-MN to treat borrowing under multi-year credit agreements as short- term debt, by varying Minn. Rules part 7825.10000, subpart 6;
5. Allow NSP-MN to enter into financings to replace outstanding long-term debt instruments with less expensive securities, and tax-exempt financings for pollution control construction programs, provided NSP-MN's next capital structure filing reports on any such financings entered into and their effect on ratepayers; and

6. Require NSP-MN to continue to follow the informational reporting requirements imposed in Order Point 6 of the Commission's June 20, 2018 Order in Docket No. E,G-002/S-17-767.

IV. NSP-MN’s Reply Comments

On February 20, 2020, NSP-MN filed its Reply Comments indicating its acceptance of all of the Department’s recommendations.

V. Staff Comment

Regarding the “one minor exception” noted by the Department, while the Department indicated that 7.01 percent is the appropriate overall rate of return on capital for Xcel to use in filings for the next 12 months, the Department did not include this point in its set of recommendations.

MN-NSP has agreed to “all of the recommendations outlined on page 13 of the Department’s Comments,” but this point is not included in the list of recommendations.

The rates of return on equity and debt are used in rider cost recovery filings – transmission cost recovery, renewable energy standards, and gas utility infrastructure cost.

In utility rider and gas infrastructure dockets, Minnesota statutes allow utilities to charge ratepayers a return on investment at the level approved in the utility’s last general rate case, unless the Commission finds a different return is consistent with the public interest.

In the July 1, 2019, “2018 Property Tax True-Up Report and Combined Refund Plan” (Docket No. E002/GR-15-826), Xcel used the <u>Commission-approved 2019 cost of short-term debt</u> as the appropriate interest rate.

However, in the transmission cost recovery rider docket (E-002/M-17-797) referenced above, Xcel initially proposed a return of equity of 10 percent to calculate the transmission revenue requirement, while Xcel and other settling parties agreed in the 15-826 rate case that Xcel could represent its authorized return on equity as 9.20 percent, and the Commission, in the transmission cost recovery rider docket, required Xcel to use a return of 9.06 percent "in all electric dockets filed by the Company that require an ROE [return on equity] until the Commission issues an order in the Company's next rate case authorizing a different ROE." Staff suggests that the Commission inquire of the parties whether there is agreement on decision alternative seven or eight in the interest of clarifying the appropriate overall cost of capital – 7.08 percent or 7.01 percent – for Xcel to use in its initial filings for the next 12 months.

On the other hand, however, it is not strictly imperative for the Commission to resolve this issue in this docket. Staff believes that the appropriate return on capital to be used in filings is a public interest-determination which the Commission can make on a case-by-case basis.

For example, Xcel files petitions for approval of transmission cost recovery riders pursuant to Minn. Stat. § 216B.16. Subd. 7b.(6) of this statute allows:

> . . . a return on investment at the level approved in the utility's last general rate case, unless a different return is found to be consistent with the public interest[.]

Likewise, the Recovery of Gas Utility Infrastructure Costs statute, Minn. Stat. 216B.1635, Subd. 6 (rate of return) provides:

> The return on investment for the rate adjustment shall be at the level approved by the commission in the public utility's last general rate case, unless the commission determines that a different rate of return is in the public interest.

VI. Decision Alternatives

(The following 1-6 points are the Department's recommendations, also accepted by Xcel):

1. Approve NSP-MN's requested 2020 capital structure and contingencies, effective until the Commission issues an order on NSP-MN's 2021 capital structure; (DOC, Xcel)

2. Allow NSP-MN to issue securities provided that the Company remains within the approved contingencies or does not go outside the approved contingencies for more than 60 days without the Commission's preapproval; (DOC, Xcel)

3. Continue to allow NSP-MN to use risk-management instruments that qualify for hedge accounting treatment under Accounting Standard Codification No. 815; (DOC, Xcel)

4. Continue to allow NSP-MN to treat borrowing under multi-year credit agreements as short- term debt, by varying Minn. Rules part 7825.10000, subpart 6; (DOC, Xcel)

5. Allow NSP-MN to enter into financings to replace outstanding long-term debt instruments with less expensive securities, and tax-exempt financings for pollution control construction programs, provided NSP-MN's next capital structure filing reports on any such financings entered into and their effect on ratepayers; (DOC, Xcel) and

6. Require NSP-MN to continue to follow the informational reporting requirements imposed in Order Point 6 of the Commission's June 20, 2018 Order, in Docket No. E,G-002/S-17-767. (DOC, Xcel)

Clarification of the cost of capital Xcel should apply to filings for the next 12 months

7. Clarify that the cost of capital Xcel may apply to filings for the next 12 months is 7.01 percent. Or

8. Clarify that the cost of capital Xcel may apply to filings for the next 12 months is 7.08 percent.