

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Barbara Beerhalter	Chair
Cynthia A. Kitlinski	Commissioner
Norma McKanna	Commissioner
Robert J. O'Keefe	Commissioner
Darrel L. Peterson	Commissioner

In the Matter of the Petition of Minnesota Power and Light Company for Approval of Capital Structure Prior to the Issuance of Securities.

ISSUE DATE: June 28, 1988

DOCKET NO. E-015/S-88-119

ORDER APPROVING PETITION

PROCEDURAL HISTORY

On February 19, 1988, Minnesota Power and Light Company (MP or the Company) filed with the Minnesota Public Utilities Commission (the Commission) a petition for approval of capital structure and permission to issue securities in 1988, pursuant to Minn. Stat. Section 216B.49 (1986) and Minnesota Rules, parts 7825.1000 to 7825.1500.

On April 4, 1988, the Minnesota Department of Public Service (DPS) submitted its Report of Investigation and Recommendation which recommended approval of the Company's proposed securities issuance and capital structure for December 31, 1988.

FINDINGS OF FACT AND CONCLUSIONS

The issue before the Commission is whether the issuances of securities proposed by the Company, and the capital structure resulting from those issuances, are reasonable, proper, in the public interest, and not detrimental to the interest of ratepayers.

MP, a Minnesota corporation, is a public utility company subject to regulation by the Commission under Minn. Stat. Section 216B.49 (1986). The Company's proposed issuance of securities requires prior approval by the Commission under this statute.

The Company requested authority to issue the following securities in 1988:

- a) Common stock not to exceed \$120,000,000 to be issued through public or private offerings, through Company's employee stock purchase plan, employee stock ownership plan, or negotiated transactions for the acquisition of the assets or capital stock of utilities providing water, wastewater treatment, telephone or related utility services.
- b) Serial preferred stock or serial preferred stock A, no par value, not to exceed \$50,000,000.
- c) First mortgage bonds or guaranty of other long-term debt not to exceed \$70,000,000 in aggregate total.
- d) Unsecured short-term promissory notes and commercial paper not to exceed \$75,000,000 in aggregate principal amount.

The proposed issuance of first mortgage bonds, additional shares of preferred and common stock, issuance of unsecured promissory notes and commercial paper, and guaranty of other long-term debt will constitute an issuance of securities within the purview of Minn. Stat. Section 216B.49 (1986).

The Company stated that proceeds from the sale of securities during 1988 will be applied in part to construction of new facilities and other corporate purposes including possible refunding of existing securities and possible acquisition of businesses which provide water, wastewater treatment, telephone and related utility services. Proceeds from the sale of short-term promissory notes will be added to the general fund to pay in part for construction programs prior to arranging for additional long-term financing.

As a result of the financing proposed, the Company's capital structure will not exceed the maximum amount shown for December 31, 1988:

Minnesota Power
Unconsolidated Capital Structure

	<u>November 30, 1987</u>		<u>December 31, 1988</u>	
	Amount		Amount	
	<u>(\$000's)</u>	<u>%</u>	<u>(\$000's)</u>	<u>%</u>
Long-term Debt	\$407,161	43.91%	\$476,500	40.55%
Preferred Stock	66,572	7.18%	114,600	9.75%
Common Equity	<u>453,498</u>	<u>48.91%</u>	<u>584,100</u>	<u>49.70%</u>
Total Capitalization	\$927,231	100.0%	\$1,175,200	100.0%

However, the Company does not anticipate actually issuing all of the securities requested nor having the maximum amounts of long-term debt or preferred stock outstanding over time. The primary purpose of any new bonds or new preferred stock issued during 1988 would be to replace higher cost

prior issues, thus reducing the overall cost of capital. The Company's best estimate of its actual 1988 year-end capital structure is as follows:

<u>Minnesota Power</u>		
<u>Unconsolidated Capital Structure</u>		
	<u>December 31, 1988</u>	
	<u>Amount (\$000's)</u>	<u>%</u>
Long-term Debt	\$406,500	43.52%
Preferred Stock	62,600	6.70%
Common Equity	<u>465,000</u>	<u>49.78%</u>
 Total Capitalization	 \$934,100	 100.00%

In addition, the Company shows a regulated utility common equity ratio of 44.52% at November, 1987 and of 44.48% by year end 1988 after excluding equity investments in diversified subsidiaries as shown in the following table:

<u>Minnesota Power</u>					
<u>Regulated Capital Structure</u>					
	<u>November 30, 1987</u>			<u>December 31, 1988</u>	
	<u>Amount</u>		<u>Amount</u>		
	<u>(\$000's)</u>	<u>%</u>	<u>(\$000's)</u>	<u>%</u>	
Long-term Debt	\$399,004	47.76%	\$398,700	48.18%	
Preferred Stock	64,448	7.72%	60,700	7.34%	
Common Equity	<u>371,936</u>	<u>44.52%</u>	<u>368,100</u>	<u>44.48%</u>	
 Total Capitalization	 \$835,388	 100.0%	 \$827,500	 100.0%	

Minn. Stat. Section 216B.49 (1986) directs the Commission to give due consideration to the nature of the business of the Company, its credit and prospects, the possibility that the value of the property may change from time to time, the effect which the issuance shall have upon the management and operation of the Company, and other considerations which the Commission as a matter of fact shall find relevant in ascertaining whether the amount of securities of each class bear a reasonable proportion to each other and to the value of MP's property.

One purpose of this statutory requirement is to prevent the utility from issuing debt which is unreasonable in proportion to the entire capitalization of the utility. Unreasonably high levels of debt in a utility's capital structure can endanger the utility's ability to finance its operations and impair its capital, thus impairing the utility's ability to provide safe and reliable service to the public.

Minn. Stat. Section 216B.49 (1986) also requires the Commission to find that the proposed capital structure is reasonable and proper and in the public interest and will not be detrimental to the interests of the consumers and patrons affected thereby. The purpose of this requirement is to prevent the utility from overissuing securities which would unreasonably burden utility ratepayers with excessive capital charges resulting in unjust and unreasonable rates.

The Commission finds that on the basis of safety to the utility's long term credit, the requested issuances of preferred and common stock, first mortgage bonds, and short-term securities and the guaranty of other long-term debt are reasonable.

Upon consideration of the nature of the business of petitioner, its credit and prospects, the possibility that the value of the property may change from time to time, and the effect which the issuance shall have upon the management and operation of the petitioner, the Commission finds that the amount of securities of each class bear a reasonable proportion to each other and to the value of the property.

The Commission further finds that the aggregate amount of the securities of the petitioner outstanding and proposed to be outstanding, if the petition is granted, will not exceed the fair value of its properties and business.

Although the requested capital structure is reasonable for the purposes of maintaining the financial integrity of the Company, the Commission also must review the proposed securities issuances for economy to ratepayers. In the Company's most recent general rate case, Minnesota Power and Light Company, Docket No.

E-015/GR-87-223 (March 1, 1988), the Commission used a regulated capital structure which excluded the equity capital invested in diversification activities from the equity portion of the Company's capital base. The Commission approved MP's proposed test year capital structure consisting of 39.48% common equity, 8.41% preferred stock, and 52.11% long-term debt.

MP's projected equity ratio for the regulated utility operations for the year ending December 31, 1988 of 44.48% is substantially higher than the 39.48% equity ratio used to determine MP's level of rates. A higher percentage of equity in the utility capital structure could increase the utility cost of capital because equity generally carries a higher cost of capital than the other sources of capital. However, the difference between the test year equity ratio and the projected equity ratio is not caused by the securities issuances being proposed herein. Rather, that difference is the result of MP's changed plans for its investment in Lake Superior Paper Industries, see In the Matter of the Petition of Minnesota Power and Light Company for Approval of Revision to Structure Prior to the Issuance of Securities, E-015/S-87-603 (November 30, 1987). Therefore, the Commission will give primary consideration to the impact which the proposed securities issuances will have on MP's ratepayers and only secondary consideration to the projected year-end capital structure.

The Commission finds that new common stock would be issued for two purposes. First, issuances may be made in conjunction with a negotiated acquisition of the capital stock of businesses engaged in water, wastewater treatment, or telecommunications utility operations. Second, a number of new shares of common stock may be issued from time to time on a continuing basis through its Employee Stock Purchase Plan (ESPP) or its Employee Stock Ownership Plan (ESOP).

These issuances would not significantly increase MP's regulated utility common equity ratio because investments in diversified investments are excluded from the capital structure for ratemaking purposes and issuances for the ESPP and the ESOP are not expected to be significant. Nevertheless, as it has in prior rate orders and orders approving the issuance of securities, the Commission continues to put MP on notice that the Company will have to justify its ratemaking capital structure in future rate cases. As the Commission noted in United Telephone Company, Docket No. P-430/GR-83-599, Order After Reconsideration (September 6, 1984) at 3: "If a company's request for an increase is due, in part, to its capital structure, the company should also bear the burden of justifying the portion of the increase attributable to its management's choice of capital structure, South Central Bell v. Louisiana PSC, 373 So.2d 478 (1979)."

The issuances of new Preferred Stock during 1988 would be for purposes of refinancing presently outstanding issues of preferred stock to lower the Company's overall cost of capital, if economic conditions permit. Proceeds from the issuances of new First Mortgage Bonds may be used to refinance all or part of the Company's Preferred Stock and \$50 million in principal amount of 9 1/4% First Mortgage Bonds due April 1, 2008 or any combination thereof, to achieve lower overall debt service costs.

Therefore, the Commission finds that the proposed securities issuances would not tend to increase the cost of capital to utility ratepayers. The Commission concludes that it is reasonable, proper, in the public interest, and not detrimental to ratepayers to approve MP's proposed securities issuances and the resulting capital structure for purposes of Minn. Stat. section 216B.49 (1986).

The Commission concludes that it is reasonable, proper, in the public interest, and not detrimental to ratepayers to approve MP's proposed securities issuances and the resulting capital structure for purposes of Minn. Stat. Section 216B.49 (1986).

Minn. Rules, part 7825.1400, Subp. 0, setting out filing requirements for petitions under Minn. Stat. Section 216B.49 (1986), requires a utility to provide "A statement of the manner in which such securities will be issued; and if invitations for sealed written proposals (competitive bidding) are not anticipated, an explanation of the decision not to invite such proposals shall be submitted." The purpose of this rule is to aid enforcement of the Commission's rules governing affiliated interests and to ensure that the costs of financing are as low as the competitive market will allow.

In its next filing, the Commission will require the Company to provide more detailed explanations of any decision not to use competitive bidding for any proposed security issuance. To support its explanations, the Company should describe what procedures were followed in security issuances since the prior security issuance approval.

The Commission finds that information about what securities were actually issued in the past year, how they were issued, and what caused any deviations from the projections made in the prior year's petition is helpful in evaluating future securities issuance petitions. Therefore, the Commission will order MP to provide such information with its next petition under Minn. Stat. Section 216B.49 (1986).

ORDER

1. MP is authorized to issue in 1988 the securities proposed in its February 19, 1988 filing.
2. The projected capital structure of the Company as set forth under "Findings of Fact" above is hereby authorized and approved. The total capitalization of petitioner shall not exceed One Billion One Hundred Seventy Five Million Two Hundred Thousand Dollars (\$1,175,200,000).
3. The net proceeds to be derived from the issuance and sale of said additional shares of preferred and common stock, first mortgage bonds, other unsecured debt, and guaranty of other long-term debt shall be applied and used substantially for the purposes set forth in the Company's petition.
4. The Company shall file a full and complete report of the consummation of the transactions involved herein, together with a statement of costs and expenses incurred therewith, no later than thirty days after the consummation of the transactions authorized herein.
5. With its next petition under Minn. Stat. Section 216B.49, the Company shall file a report containing the following:
 - A. A description of the actual securities issued during 1988;
 - B. The method of each issuance, including an explanation if competitive bidding was not used;
 - C. The issuance costs of each offering; and
 - D. An explanation of any deviations between the capital structure estimated for December 31, 1988 in the instant docket and the new petition.
6. With its next petition under Minn. Stat. Section 216B.49, the Company shall provide a description of the issuance method proposed for each securities offering for which approval is requested, including a thorough explanation for any issuance where the Company does not propose to use competitive bidding procedures.
7. This order shall become effective immediately.

BY ORDER OF THE COMMISSION

Mary Ellen Hennen
Executive Secretary

(S E A L)