

E-015/S-88-974 APPROVING PETITION

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: March 28, 1989

DOCKET NO. E-015/S-88-974

ORDER APPROVING PETITION

PROCEDURAL HISTORY

On December 15, 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 1989, pursuant to Minn. Stat. § 216B.49 (1988) and Minnesota Rules, parts 7825.1000 to 7825.1500.

On January 19, 1989, the Minnesota Department of Public Service (DPS) submitted its Report of Investigation and Recommendation which recommended approval of the Company's proposed issuances of securities and capital structure for 1989.

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. § 216B.49 (1988). 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 1989:

- 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, 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. § 216B.49 (1988).

The Company stated that proceeds from the sale of securities during 1989 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, 1989:

<u>Minnesota Power</u>					
<u>Unconsolidated Capital Structure</u>					
		Actual		Maximum Projected	
		<u>October 31, 1988</u>		<u>December 31, 1989</u>	
		Amount		Amount	
		(\$000's) %		(\$000's) %	
Long-term Debt	\$406,472	43.03%	\$ 473,723	38.74%	
Preferred Stock	62,572	6.63	110,600	9.04	
Common Equity	<u>475,501</u>	<u>50.34</u>	<u>638,500</u>	<u>52.22</u>	
Total Capitalization	\$944,545	100.00%	\$1,222,823	100.00%	

However, the Company does not anticipate actually issuing the proposed maximum amounts of securities in 1989. The primary purpose of any issuances of long-term debt or preferred stock would be to replace higher cost outstanding issues to reduce the overall cost of capital. MP states that common stock issued in 1989 would be primarily for non-utility diversification purposes. The Company's best estimate of its actual 1989 year-end capital structure is as follows:

<u>Minnesota Power</u>			
<u>Unconsolidated Capital Structure</u>			
		Best Estimate December 31, 1989	
		<u>Amount (\$000's)</u>	<u>%</u>
Long-term Debt		\$403,723	41.11%
Preferred Stock	58,600	5.97	
Common Equity		<u>519,602</u>	<u>52.92</u>
 Total Capitalization	 \$981,925	 100.00%	

In addition, the Company presented its capital structure for ratemaking purposes, which excludes equity investments in diversified subsidiaries. MP shows a regulated utility common equity ratio of 44.70% at October 31, 1988 and of 44.96% by year-end 1989 as shown in the following table:

<u>Minnesota Power</u>					
<u>Regulated Capital Structure</u>					
		Actual		Best Estimate	
		<u>October 31, 1988</u>	<u>December 31, 1989</u>		
		<u>Amount</u>	<u>Amount</u>		
		<u>(\$000's)</u>	<u>(\$000's)</u>	<u>%</u>	<u>%</u>
Long-term Debt	\$399,332	48.02%	\$397,253	48.15%	
Preferred Stock	60,586	7.28	56,800	6.89	
Common Equity		<u>371,747</u>	<u>44.70</u>	<u>370,902</u>	<u>44.96%</u>
 Total Capitalization	 \$831,665	 100.00%	 \$824,955	 100.00%	

Minn. Stat. § 216B.49 (1988) 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.

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 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.

The Commission further 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.

Minn. Stat. § 216B.49 (1988) 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.

In the Company's most recent general rate case, Minnesota Power and Light Company, Docket No.E-015/GR-87-223 (March 1, 1988), MP proposed, and the Commission adopted, a capital structure for ratemaking purposes which excluded the equity capital invested in diversification activities. The approved capital structure consisted of 39.48% common equity, 8.41% preferred stock, and 52.11% long-term debt.

MP's projected equity ratio for regulated utility operations for the year ending December 31, 1989 of 44.96% is substantially higher than the 39.48% equity ratio used to establish rates in MP, E-015/GR-87-223. A higher percentage of equity in the capital structure could increase the cost of capital borne by ratepayers because equity generally has a higher cost rate than other sources of capital. However, the difference between the equity ratio used in the recent rate case and that projected for 1989 is not caused by the securities issuances proposed herein. Rather, this difference is primarily the result of MP's changed plans for its investment in Lake Superior Paper Industries.

MP indicated that any new common stock would be issued for two main purposes: (1) acquisition of the capital stock of businesses engaged in water, wastewater treatment, or telecommunications utility operations, and (2) to fund its employee stock purchase plans. The Commission finds that these issuances are not likely to significantly increase MP's common equity ratio for ratemaking purposes. This is true because investments in diversified investments have been excluded from the capital structure for ratemaking purposes and because issuances for employee stock plans are expected to be minimal.

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)."

Based on the above findings, the Commission concludes that the financing proposed by MP should

not have a detrimental effect on utility ratepayers. Therefore, the Commission further concludes that it is reasonable, proper, and in the public interest to approve MP's proposed securities issuances and the resulting capital structure for purposes of Minn. Stat. § 216B.49 (1988).

Minn. Rules, part 7825.1400, subp. 0, setting out filing requirements for petitions under Minn. Stat. § 216B.49 (1988), requires a utility to provide a statement of the manner in which securities will be issued and an explanation if competitive bidding is not to be used. 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. § 216B.49 (1988).

The Commission required similar information in its ORDER APPROVING PETITION In the Matter of the Petition of Minnesota Power and Light Company for Approval of Capital Structure Prior to the Issuance of Securities, Docket No. E-015/S-88-119 (June 28, 1988). The Company has provided the requested information.

ORDER

1. Minnesota Power Company's request for approval of securities issuances and capital structure for 1989 is granted.
2. The Company is authorized to issue the following securities, as described more fully in its Petition, in 1989: \$75 million in short-term debt, \$70 million in long-term debt, \$50 million in preferred stock, and \$120 million in common stock.
3. The net proceeds to be derived from the issuance and sale of the securities described above shall be used for the purposes set forth in the Company's petition.
4. The Company shall file a full and complete report of the issuance of any securities, together with a statement of expenses incurred and the information required in Minn. Rules, part 7825.1500, no later than thirty days after the completion of the issuance.
5. With its next petition under Minn. Stat. § 216B.49, the Company shall file a report containing the following:

- A. A description of securities issued during 1989;
 - 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, 1989 in the instant docket and the new petition.
 - E. A description of the issuance method proposed for each offering for which approval is requested, including a thorough explanation for any issuance where the Company does not propose to use competitive bidding procedures.
6. This order shall become effective immediately.

BY ORDER OF THE COMMISSION

Mary Ellen Hennen
Executive Secretary

(S E A L)