

E-015/S-93-1284 ORDER APPROVING CAPITAL STRUCTURE

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Don Storm
Tom Burton
Marshall Johnson
Cynthia A. Kitlinski
Dee Knaak

Chair
Commissioner
Commissioner
Commissioner
Commissioner

In the Matter of the Petition of Minnesota
Power and Light Company for Approval of its
1994 Estimated Capital Structure Prior to the
Issuance of Securities for Calendar-Year 1994

ISSUE DATE: May 9, 1994

DOCKET NO. E-015/S-93-1284

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PROCEDURAL HISTORY

On December 20, 1993, Minnesota Power and Light Company (MP or the Company) filed its annual request for approval of its capital structure and permission to issue securities for calendar year 1994.

On January 3, 1994, the Minnesota Department of Public Service (the Department) filed its Report of Investigation and Recommendation in this matter.

On March 10, 1994, MP filed reply comments to the Department's report and recommendations.

On March 24, 1994, the Department responded to MP's reply comments.

On April 14, 1994, the Commission met to consider this matter.

FINDINGS AND CONCLUSIONS

A. Overview

Minnesota law requires public utilities that are incorporated in the State of Minnesota or that encumber property in the state to obtain Commission approval of their capital structures prior to issuing securities. Minn. Stat. § 216B.49 (1992). The statute gives the Commission a great deal of discretion on how it approaches capital structure reviews. It sets out a number of elements the Commission must consider and approve, but does not specify a particular procedure for doing so.

B. Background

In the course of reviewing the 1992 annual capital structure filings, the Commission developed a growing concern regarding its statutory responsibility to provide regulatory oversight of utilities' capital structures.

In recent Orders, the Commission has carefully reviewed the capital structures of Northern States

Power Company (NSP) and Otter Tail Power Company (OTP).¹ While approving the companies' proposed capital structures, the Commission adopted procedural measures to improve the Commission's ability to execute its statutory oversight responsibilities in this area. Specifically, the Commission narrowed the range by which the companies were authorized to vary from their best estimate capital structures before being required to seek additional Commission authorization.

In the present Order, the Commission considers MP's request for authorization of its capital structure and specific contingency issuance levels. In this Order, the Commission continues the direction initiated in the NSP and Otter Tail capital structure dockets.

C. Issues

1. Capital Structure for What Activities

MP submitted three capital structures: one which covered its regulated activities, a consolidated structure which included both its regulated and non-regulated activities, and a non-consolidated structure.

The Commission must have a comprehensive view of the Company's entire financial picture because securities activity in the subsidiaries will impact the Company's debt ratio, either positively or negatively. Therefore, the Commission will review and approve the Company's consolidated capital structure.

2. What Securities Issuances Must Be Authorized

In its comments, the Company stated that it interpreted Minn. Stat. § 216B.02 and § 216B.49 (1992) as only requiring Commission authorization of securities sold for the electric utility, not those issued by its unregulated subsidiaries. The Company emphasized that it was only seeking authorization for issuances in support of its electric utility operations.

The Department did not disagree with the Company's statutory interpretation, but noted that the long-term debt issued by the Company to support its non-regulated subsidiaries may negatively impact the Company's debt ratio.

The Commission acknowledges the points and clarifications made by both parties. As noted above, the capital structure which the Commission will review and approve will be MP's consolidated capital structure. At the same time, the specific security issuances which the Commission is called upon to authorize are only those for or by the Company's regulated activities.²

¹ See In the Matter of the Petition of Otter Tail Power Company for Approval of its 1994 Estimated Capital Structure Prior to the Issuance of Securities for Calendar-Year 1994, Docket No. E-017/S-93-1091, ORDER APPROVING CAPITAL STRUCTURE (January 26, 1994) and In the Matter of the Petition of Northern States Power Company for Approval of its 1994 Estimated Capital Structure Prior to the Issuance of Securities for Calendar-Year 1994, Docket No. G, E-002/S-93-1065, ORDER APPROVING CAPITAL STRUCTURE (January 26, 1994).

² To sort this out: MP issues common stock for itself and for the benefit of its non-regulated subsidiaries. These issuances are subject to prior Commission approval under Minn. Stat. § 216B.49 (1992). MP also issues long-term debt for itself and its subsidiaries: authorization required. Some of its subsidiaries may also issue additional long-term debt for themselves which is not guaranteed by MP: authorization not required.

In sum, the Commission clarifies that it need not (and in this Order does not) review and authorize long-term or other securities issuances by the Company's non-regulated subsidiaries on their own behalf.

3. Limits on MP's Stock Issuance

In its initial filing, the Company stated that it planned to issue \$1.1 million of common equity in 1994 and no long-term debt. Nevertheless, the Company requested authority to issue up to \$120 million in common stock and \$200 million in long-term debt. In total, the Company requested authority to issue \$470 million worth of securities.³

The following two scenarios illustrates the size of the requested contingency:

Issuance Scenario 1:

The maximum requested/ authorized long-term debt:	\$774,765
Resulting long term debt:	65.06 %
Resulting common equity:	30.86 %

Issuance Scenario 2:

The maximum requested/ authorized common equity:	\$686,400
Resulting long term debt:	38.28 %
Resulting common equity:	57.64 %

The Department stated that it would have been much better if the Company had provided specific information about events in the coming year that it foresaw as occasioning contingency issuances. The Commission would then have been able to assess the reasonableness of the requested contingency amounts in light of that information.

In the absence of such information, the Department encouraged the Commission to approve the projected capital structure but to subject the contingency issuances to a governing mechanism. The Department proposed establishing an allowable range for the Company's debt ratio. As parameters for the allowable range, the Department recommended using values consistent with debt ratios of companies whose bonds are rated one step above and one step below MP's rating. The benchmark debt ratio for bonds one level above the Company's A rating (AA) is 42 percent and the ratio for bonds one level below MP (BBB) is 54 percent. The Department recommended using these values as the range (window) of MP's authority to issue securities.

In reply comments, MP questioned whether it should be required to maintain any particular financial ratios between its various financial components. The Company argued that previous capital structure Orders which imposed no such ratios had worked well, enabling the Company to refinance its debt at more economic rates and pursue its diversification strategy through acquisitions made largely by its non-regulated subsidiaries.

In addition, MP explained that its request for authorization to issue up to \$200 million long-term debt was an attempt to avoid the time and expense of reapplying to the Commission for additional authority if an opportunity arose which could result in the Company exceeding a lower authorization. The Company noted that the capital structure Order issued for 1992

³ In addition to the previously stated levels for common stock and long-term debt, MP requested authority to issue up to \$50 million of preferred stock and \$100 million of short-term debt.

authorized a fairly low amount. As a result, when it initiated a series of refinancing activities that year, it had to make frequent reapplications to the Commission for additional authority.

Nevertheless, the Company supported the use of the 54 percent maximum consolidated debt-to-total capitalization ratio and in oral comments withdrew its opposition to the use of a minimum debt ratio.

D. Commission Action

The Commission will approve MP's proposed consolidated capital structure.

Long Term Debt	\$567,500	47.65 %
Preferred Equity	48,547	4.08
Common Equity	574,765	48.27
Total	\$1,190,812	100.0 %

However, the Company has not stated why it needs a contingency authorization of the size requested. In the absence of any explanation, the Commission cannot find that the requested contingency levels are reasonable. The Commission will act to establish reasonable regulatory oversight by setting an upper and lower bound for the Company's debt ratio.

Specifically, the Commission will authorize the Company to issue securities in the amounts requested, but only to the extent that the Company's debt ratio remains within the range established in this Order: between 42 and 54 percent. If a contemplated transaction would move the Company's debt ratio outside those boundaries, the Company will be required to request authorization before concluding that transaction.

E. Looking Ahead

The Commission views the maximum/minimum debt ratios established in this Order as an intermediate step in the evolution of its oversight of the Company's capital structure. With next year's capital structure filing, the Company will be required to provide specific information on foreseeable events in the coming year that would result in the need to issue securities in the amounts requested for contingency issuances. Based on this information, the Commission will be in a better position to evaluate the reasonableness of the Company's contingency requests and perhaps take a different approach, e.g. to approve the most significant and likely contingency capital structures and contingency issuances.

To obtain more desirable information for next year's review, the Commission will direct the Company in its next capital structure filing to include

- a list of the most likely economic or financial events that could result in the need to issue securities in the amounts similar to the amounts requested for contingency issuances; and
- for each event identified, the contingency capital structure corresponding to the event in question.

Finally, the Commission finds it desirable to afford the Company sufficient flexibility to obtain financing at the beginning of 1995. Therefore, the Commission will make this Order effective through the first three months of 1995 or until an Order approving the Company's 1995 capital structure, whichever comes first.

ORDER

1. The estimated consolidated capital structure submitted by Minnesota Power and Light Company (MP or the Company) is approved. Authorization to issue securities in the requested amounts is granted with the modification that no issuance is authorized that would result in the Company's debt ratio falling below 42 percent or exceeding 54 percent.
2. Until March 31, 1995 or until a subsequent Order approving a capital structure for 1995, whichever comes first, MP is authorized to make one or more issuances of securities, provided that the impact of the issuance or issuances on the Company's capital structure is not to exceed the contingency ranges for debt ratio established in this Order .
3. As soon as the Company has reason to know that a contemplated securities issuance would cause the debt ratio to exceed the authorized limits, it shall seek approval from the Commission for any such issuance.
4. In its next capital structure request, MP shall provide
 - a. a list of the most likely economic or financial events that could result in the need for significant amounts of contingency issuances of securities and
 - b. for each event identified above, the contingency amounts to be issued and the contingency capital structure corresponding to these amounts.
5. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

(S E A L)