Minnesota Public Utilities Commission

Staff Briefing Papers

Meeting Date: **January 6, 2011** .... **Agenda Item #** .

Company: Xcel Energy

Docket No. E,G-002/S-10-1158
In the Matter of the Petition of Northern States Power Company, a Minnesota Corporation, for Approval of Capital Structure for Issuance of Long-Term and Short-Term Securities for 2011

Issue: Should the Commission approve the issuance of securities and the proposed capital structure?

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Relevant Documents

Xcel Initial Filing .... Filed October 29. 2010
Xcel Revised Attachment N .... Filed November 17, 2010
OES Comments .... Filed November 19, 2010
Xcel Reply Comments .... Filed November 29, 2010

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December 17, 2010

Statement of the Issue

Should the Commission approve the issuance of securities and the proposed capital structure?

Background

On October 29, 2010, Xcel Energy filed a petition with the Commission asking on behalf of Northern States Power Company for approval of:

- The proposed capital structure and total capitalization.
- Continued authorization of the ability to issue securities provided the Company remains within the approved capital structure.
- Continued flexibility to use risk management instruments to reduce the cost of capital.
- A continuation of the variance of Minn. Rules, part 7825.1000, subp. 6 to allow the Company to treat borrowings under multi-year credit agreements as short-term debt.
- Discretion to enter into financings to replace outstanding long-term debt instruments with less expensive securities, and to enter into tax-exempt financings for pollution control construction programs.
- The 2011 capital structure until the Commission issues a 2012 capital structure Order.

On November 17, 2010, Xcel filed a Revised Attachment N (Planned Investments). This filing updated its 2010 capital forecast with (1) Actuals through September 2010; and, (2) An estimate for the fourth quarter.

On November 19, 2010, the Office of Energy Security submitted comments recommending approval of the petition with reporting requirements.

On November 29, 2010, Xcel submitted reply comments, appreciating the OES recommendation and accepting the reporting requirements outlined by the OES.

Relevant Statute

Minn. Stat. § 216B.49, subd. 3:

> It shall be unlawful for any public utility organized under the laws of this state to offer or sell any security or, if organized under the laws of any other state or foreign country, to subject property in this state to an encumbrance for the purpose of securing the payment of any indebtedness unless the security issuance of the public utility shall

> first be approved by the commission. Approval by the commission shall be by formal written order.

Subd. 4 of the same statute:

> Upon the application of a public utility for approval of its security issuance and prior to the issuance of any security or the encumbrance of any property for the purpose of securing the payment of any indebtedness, the commission may make such inquiry or investigation, hold such hearings, and examine such witnesses, books, papers, documents, or contracts, as in its discretion it may deem necessary. Prior to approval the commission shall ascertain that the amount of securities of each class which any public utility may issue shall bear a reasonable proportion to each other and to the value of the property, due consideration being given to the nature of the business of the public utility, its credit and prospects, the possibility that the value of the property may change from time to time, the effect which the issue shall have upon the management and operation of the public utility, and other considerations which the commission as a matter of fact shall find to be relevant. If the commission shall find that the proposed security issuance 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 commission shall by written order grant its permission for the proposed public financing.

Positions of the Parties

Xcel Energy

The Company reported that, as of September 30, 2010, it was in compliance with the 2010 Capital Structure *Order*,[1] as follows:

Total Capitalization: $6,834 million, within the approved limit of $7,500 million;

Short-term Debt Balance: $0 million, within the approved limit of up to 15 percent of total capitalization; and

Equity Ratio: 51.2 percent, within the approved range of 45.99 percent to 56.21 percent.

For 2011, Xcel asked the Commission to approve:

- Total capitalization of $8,100 million, including a contingency of $439 million.

[1] Docket No. 3,G-002/S-09-1161.

- An equity ratio of 52.1 percent, with a contingency range of $\pm$ 10 percent.
- The ability to issue short-term debt not to exceed 15 percent of total capitalization.
- Continuation of the variance permitting the the Company 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 the Company 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.
- The discretion to enter into financings to replace outstanding long-term debt instruments with less expensive securities, and to enter into tax-exempt financings for pollution control construction programs.
- The 2011 capital structure until the Commission issues a 2012 capital structure Order.

NSP's capital structure on June 30, 2010 is shown in Table 1.

Table 1: NSP Consolidated June 30, 2010, Actual

Type of Capital	**Amount ($ millions)**	**Percent**
Common Equity	3,445	52.5
Short-Term Debt	105	1.6
Borrowings Under 5-Year Credit Facility	-	0.0
Long-Term Debt	3,014	45.9
Total Capitalization	**6,564**	**100.0**

The Company estimated its capital structures as of December 31, 2010, and December 31, 2011, as shown in Tables 2 and 3, respectively.

Finally, the estimated maximum capitalization for 2011 is shown in Table 4.

The Company reported its actual and anticipated securities transactions for 2010:

- By June 30, 2010, it had received equity infusions of approximately $200 million since the beginning of the year.

Table 2: NSP Consolidated December 31, 2010, Forecast

Type of Capital	Amount ($ millions)	Percent
Common Equity	3,659	51.5
Short-Term Debt	106	1.5
Borrowings Under 5-Year Credit Facility	-	0.0
Long-Term Debt	3,338	47.0
Total Capitalization	**7,103**	**100.0**

Table 3: NSP Consolidated December 31, 2011, Forecast

Type of Capital	Amount ($ millions)	Percent
Common Equity	3,990	52.1
Short-Term Debt	32	0.4
Borrowings Under 5-Year Credit Facility	-	0.0
Long-Term Debt	3,639	47.5
Total Capitalization	**7,661**	**100.0**

Table 4: NSP Consolidated, 2011 Maximum

Type of Capital	Amount ($ millions)	Percent
Common Equity	4,003	50.9
Short-Term Debt	230	2.9
Borrowings Under 5-Year Credit Facility	-	0.0
Long-Term Debt	3,639	46.2
Total Capitalization	**7,872**	**100.0**

- As of June 30, 2010, it had approximately $45 million outstanding commercial paper and short-term debt of approximately $60 million in loans from the utility money pool.
- On August 1, 2010, $175 million senior notes matured. The Company used commercial paper and short-term loans from the utility money pool to meet this maturity until paying those off with proceeds from a long-term debt issuance.
- On August 11, 2010, the Company issued a total of $500 million first mortgage bonds in two $250 million tranches: (1) a 5-year maturity with an interest rate

of 1.95 percent; and (2) a 30-year maturity with an interest rate of 4.85 percent.

- The Company anticipated receiving equity infusions of approximately $125 million in the second half of 2010.

Xcel said it will need more capital than it now has during the period the Commission's authorizing order is in effect, estimating it will spend $1,227 million on capital projects during 2011. Major capital investments will be made for Energy Supply, including NSP-MN-owned wind development, Nuclear fuel, capacity increases and life extensions, the Distribution System, and Transmission projects, including CapX 2020.

The Company proposed to obtain the capital for those investments from:

- Short-term debt and multi-year credit agreements.
- Long-term debt including a forecast for a $300 million debt issuance in the third quarter of 2011. The size could change depending on market conditions and funding requirements at the time.
- Equity. The Company expects infusions of approximately $190 million from its parent company.

Xcel asked for a variance from Minn. Rules, part 7825.1000, subp. 6:

> "Short-term security"means any unsecured security with a date of maturity of no more than one year from the date of issuance; and containing no provisions for automatic renewal or "roll over" at the option of either the obligee or obligor.

Xcel said a variance to this rule would be needed for the Company to treat borrowings under multi-year credit agreements as short-term debt. Without such a variance, these direct borrowings would be unavailable, unless the Commission permits greater flexibility with regard to long-term debt. Because the purposes and uses for these borrowings resemble traditional use of short-term securities, they should be counted with the short-term debt, subject to the 15 percent limit. Credit rating agencies view the multi-year credit agreements as enhanced liquidity structures; without them the Company could experience fewer financing options and increased financing costs and fees. Thus, enforcement of the rule would impose an excessive burden on the Company and its ratepayers.

Xcel said the Commission will retain oversight of these types of financing instruments through annual capital structure filings, the 15 percent limit, the equity ratio, and the equity ratio ranges. Granting the variance would not adversely affect the public interest.

Finally, Xcel said, granting the variance would not conflict with law. The three-part test for variances set forth in Minn. Rules, part 7829.3200 is satisfied, as demonstrated above. Xcel currently has a variance from this Rule, granted in the Commission's securities issuance Order dated January 13, 2009, in Docket No. E,G-002/S-08-1180.

Office of Energy Security

The OES reviewed the proposed capital structure in comparison with other electric utilities with comparable risk, as measured by bond ratings. It noted that NSP-MN had a higher equity ratio and lower debt ratio than the group, and concluded that there should be no concerns about equity ratios that are too low to ensure the financial health of the Company.

The OES reviewed the contingencies requested by the Company:

Common Equity Ratio The OES said the requested range from 46.89% to 57.31%, with an average of 52.1%, is a reasonable balancing of financial flexibility, financial soundness, and Commission oversight. The identified equity infusions will keep the equity ratio within the proposed range.

Short-Term Debt The request to issue short-term debt as needed not to exceed 15 percent of total capitalization at any time is consistent with the flexibility authorized for the 2010 Capital Structure, and is reasonable in view of the Company's short-term fluctuations in revenues and expenditures.

Total Capitalization The proposed total capitalization of $8,100 million includes a contingency amount of $439 million, or about 5.7% of the total. This contingency allows flexibility in funding utility construction and unforeseen business or financial conditions that may develop. It is also necessary because, during a refinancing, both the old and new debt issues may be outstanding temporarily.

With respect to the multi-year credit facility, the OES reviewed Xcel's report on its use, and concluded that the experience with it confirms that it provides flexibility, lower fees, and adequate Commission oversight. The OES recommended that the Commission allow the variance to be continued, as long as NSP is required to continue to report on its use of the multi-year facility.

The OES reviewed the petition with respect to the requirements of the Commission's May 12, 2009 *Order Augmenting Information Required in Connection with Securities Issuances and Annual Capital Structure Filings*, Docket No. E,G 999/CI-08-1416. The OES said that Attachments N and H successfully addressed the requirements of the *Order*.

The OES recommended that the Commission continue to approve the Company's use of risk-management instruments.

In conclusion, the OES recommended that the Commission take these actions:

- Approve NSP's requested 2011 capital structure; this approval will be in effect until the 2012 Capital Structure Order is issued;

- Approve a $\pm$ 10 percent range around NSP-MN's common equity ratio of 52.1 percent (i.e., a range of 46.89 to 57.31 percent);
- Approve NSP-MN short-term debt issuance not to exceed 15 percent of total capitalization at any time while the 2011 Capital Structure is in effect;
- Approve NSP's total capitalization contingency of $439 million (i.e., a total capitalization of $8,100 million, including the $439 million);
- Continue the variance authorizing NSP-MN to enter into multi-year credit agreements and issue associated notes thereunder, but require NSP-MN to also continue 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;
- Approve NSP-MN's request to issue securities provided that the Company remain within the contingency ranges or does not exceed them for more than 60 days;
- Require NSP-MN to obtain Commission pre-approval of any issuance expected to result in the Company remaining outside the Contingency ranges for more than 60 days;
- Approve NSP-MN's flexibility to use risk-management instruments that qualify for hedge accounting treatment under ASC No. 815;
- In its next capital structure filing NSP-MN shall include an exhibit providing 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 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;
- In its next annual capital structure filing, NSP-MN shall include 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; and
- Within 20 days of each non-recurring security issuance, NSP-MN shall file for information purposes only an after-the-fact report providing the following information: 1) the type of security issues; 2) the total amount issued; 3) the purpose of the issuance; 4) the issuance cost associated with the security issuance; and 5) the total cost of the security issuance, including details such as interest rate or cost per share of common equity issued.

Staff Discussion

Attachment N

Last year, staff recommended approval of Xcel's proposal, with the addition of a schedule showing planned investments:

> Staff thinks the Company could improve its filing in the next application by providing not only the narrative, but also a table, or schedule, showing, for various time periods, the planned investments for each project. The following year's application could then use that same schedule to show what actually happened. A narrative explanation could be provided where the planned differed significantly from the actual.

The Commission approved that requirement, and Xcel's very interesting Attachment N is the result. The comments that follow refer to Revised Attachment N, filed on November 17, 2010.

For 2011 we see spending ramping down on the Nobles Wind project, but ramping up on the Merricourt Wind project. Black Dog Repowering, estimated to peak in 2014, begins to be noticed in 2011. Spending on Other Energy Supply exceeds that of 2010, and growth in that spending is expected to continue through 2013. With respect to nuclear categories, spending will be up nearly across the board. The Monticello Extended Power Uprate & LCM peaks and finishes in 2011, while Prairie Island is ramping up. Distribution investments are up, and Transmission investments are up sharply, as CapX 2020 moves from about $26 million in 2010 to $64 million in 2011, and continues increasing to $308 million in 2013. In the "Other" category, spending remains constant around $46-48 million through 2015. The narrative on pages 3 and 4 of the original Attachment N describes many of these projects. Attachment N provides a useful framework for the information that enables the Commission to find that issuance of the securities would be "reasonable and proper and in the public interest." Staff notes that Attachment N is part of the reporting requirements proposed by the OES, and encourages the Commission to again require it.

Next, observe the differences between the estimated 2010 year-end spending levels and those projected in the previous Capital Structure filing. In total, the Company overestimated how much it would invest this year by about $119 million, or about 9%. This total is not at all bad for a projection, but looking only at the total masks some pretty remarkable differences. The Company underestimated its spending on both wind generation and nuclear total by approximately 10%. It estimated spending $100 million on CapX 2020, but ended up investing less than $30 million. Its 2010 spending on Distribution came to approximately $175 million, but, according to the schedule, it had not estimated any investment there. Finally, it spent approximately $40 million in the "Other" category, whereas it estimated $530 million. It would certainly be helpful if, in next year's filing, the Company were to include a narrative discussing how these kinds of differences came about.

Equity Ratio

Staff has some discomfort over the Commission's being asked to approve an equity ratio that might well be excessive, at the upper end of the range. The OES examined 20 companies it considered comparable to Xcel. The average equity ratio was 46.23%, and only one company had an equity ratio above 50—Exelon Corp had a ratio of 52.42%. Here, Xcel is asking for 52.1%, with an upper bound of 57.31%. 52.1% is two standard deviations above the average of the group.[2] 57.31% is 3.75 standard deviations above the group average. In contrast, the lower bound, 46.89% is still 66 basis points *above* the group average.

While approval of the capital structure for purposes of issuing securities is more concerned with ensuring that the Company maintains its financial strength, there may be a limit beyond which ratepayers will be harmed if the Commission continues to approve higher and higher equity ratios. Staff raises this as a concern the Commission may wish to explore with the Company. The Commission has always reserved its right to use a more appropriate capital structure for ratemaking purposes, if necessary.

Conclusion

Staff notes that Xcel and the OES agree that the petition should be approved and that the OES recommendations should be implemented.

Decision Alternatives

1. Approve the petition (including the variance to Minn. Rules, part 7825.1000, subp. 6).
   a) Approve the petition, incorporating the recommendations of the OES.
   b) Approve the petition, without incorporating the recommendations of the OES.
2. Direct the Company to include in next year's Attachment N a discussion of the factors which caused substantial discrepancies between estimated and actual capital spending on individual projects during the year the approved capital structure and securities issuance permissions were in effect.
3. Deny the petition.

[2] See OES Attachment No. 1.

Recommendation

Staff recommends Alternatives 1a and 2.