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DUKE ENERGY OHIO EXHIBIT ______

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Duke Energy Ohio, Inc., for an Increase in Gas Rates.	)))	Case No. 12-1685-GA-AIR
In the Matter of the Application of Duke Energy Ohio, Inc., for Tariff Approval.	)))	Case No. 12-1686-GA-ATA
In the Matter of the Application of Duke Energy Ohio, Inc., for Approval of an Alternative Rate Plan for Gas Distribution Service.	))))	Case No. 12-1687-GA-ALT
In the Matter of the Application of Duke Energy Ohio, Inc., for Approval to Change Accounting Methods.	)))	Case No. 12-1688-GA-AAM

DIRECT TESTIMONY OF

STEPHEN G. DE MAY

ON BEHALF OF

DUKE ENERGY OHIO, INC.

______ Management policies, practices, and organization

______ Operating income

______ Rate base

______ Allocations

______ Rate of return

______ Rates and tariffs

__X__ Other: Capital Structure

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I. INTRODUCTION AND PURPOSE

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Stephen G. De May, and my business address is 550 South Tryon Street, Charlotte, North Carolina 28202.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by Duke Energy Business Services LLC (DEBS) as Vice President and Treasurer. DEBS provides various administrative and other services to Duke Energy Ohio, Inc., (Duke Energy Ohio or the Company) and other affiliated companies of Duke Energy Corporation (Duke Energy).

Q. PLEASE BRIEFLY SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND PROFESSIONAL EXPERIENCE.

A. I have a Bachelor of Arts degree in Political Science from the University of North Carolina at Chapel Hill, and a Master of Business Administration degree from the McColl School of Business at Queens University in Charlotte, North Carolina. In 2010, I completed the Advanced Management Program at the Wharton School of the University of Pennsylvania. I am a Certified Public Accountant (CPA) in the state of North Carolina and I am a member of the American Institute of Certified Public Accountants and the North Carolina Association of CPAs.

My professional work experience began in 1986 with the public accounting firm of Price Waterhouse (now PricewaterhouseCoopers) and, subsequently, Deloitte, Haskins and Sells (now Deloitte & Touche), where my work focused on tax accounting and consulting for a variety of clients. In 1990, I joined Crescent Resources, Inc., a then wholly-owned real estate development subsidiary of Duke Power Company (a predecessor company to today's Duke Energy) where I was responsible for real estate accounting and finance. In 1994, I moved to the Treasury and Corporate Finance Department where I have held, except for a two-year period of time, various positions of increasing responsibility. The two-year exception was for the majority of 2004 and 2005, during which time I had the lead responsibility for developing and managing Duke Energy's energy and regulatory policies. I was named Treasurer in November 2007 and led the Investor Relations function for Duke Energy from October 2009 through June 2012. Upon the closing of the merger with Progress Energy, I was named Vice President and Treasurer.

Q. PLEASE SUMMARIZE YOUR RESPONSIBILITEIS AS VICE PRESIDENT AND TREASURER.

A. As Vice President and Treasurer, I am responsible for treasury related services to Duke Energy and its subsidiaries, including Duke Energy Ohio. I monitor trends in the investment markets and maintain key relationships with debt investors, analysts, and financial institutions. Under my supervision, the Treasury Department arranges and executes all capital raising and liquidity transactions, including credit facilities and commercial paper, debt securities, preferred and hybrid securities, and common stock, as well as daily cash management for Duke Energy and its subsidiaries. My responsibilities include managing Duke Energy's and its subsidiaries' credit ratings and relationships with the major credit rating agencies, commercial banks, and the capital markets.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE PUBLIC UTILITIES COMMISSION OF OHIO?

A. Yes. Most recently, I provided testimony in support of Duke Energy Ohio's 2011 standard service offer (SSO) filing (11-3549-EL-SSO, *et al.*) as well as the last electric and gas rate case applications (Case Numbers 08-709-EL-AIR, *et al.*, and 07-589-GA-AIR, *et al.*, respectively).

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THESE PROCEEDINGS?

A. My testimony will address Duke Energy Ohio's financial objectives, capital structure, and cost of capital. I will also discuss the current credit ratings and forecasted capital needs of Duke Energy Ohio. Throughout my testimony, I will emphasize the importance of Duke Energy Ohio's continued ability to meet its financial objectives and maintain strong credit quality. I sponsor Schedules D-1A, D-1B, D-2A, D-2B, D-3A, D-3B, D-4A, and D-4B and page 3 of Schedules D-5A and D-5B. I also sponsor Supplemental Filing Requirement (C)(3).

II. DUKE ENERGY OHIO'S FINANCIAL OBJECTIVES

Q. WHAT ARE DUKE ENERGY OHIO'S FINANCIAL OBJECTIVES?

A. The Company at all times seeks to maintain its financial strength and flexibility, including its strong investment-grade credit ratings, thereby ensuring reliable access to capital on reasonable terms. Financial strength and access to capital are necessary for Duke Energy Ohio to provide cost-effective, safe, and reliable service to its customers. Specific targets that support financial strength and flexibility include: 1) maintaining an equity component of the capital structure that is within the rating agencies' guidelines for Duke Energy Ohio's credit rating; 2) maintaining current credit ratings; 3) ensuring timely recovery of prudently incurred costs; 4) maintaining sufficient cash flows to meet obligations; and 5) maintaining a sufficient return on equity to fairly compensate shareholders for their invested capital. The ability to attract capital (both debt and equity) on reasonable terms is vitally important to the Company and its customers, and each of these targets help the Company to meet its overall financial objectives.

Q. HOW DOES THE RECENTLY APPROVED ELECTRIC SECURITY PLAN (ESP) IMPACT DUKE ENERGY OHIO'S FINANCIAL OBJECTIVES?

A. Pursuant to the ESP approved by the Commission on November 22, 2011, Duke Energy Ohio has committed to transferring its legacy generating assets to an affiliate or subsidiary no later than December 31, 2014. Although this commitment provides clarity in respect of the structure of the Company, it does increase Duke Energy Ohio's business risk as it will continue to own non-regulated assets in the near term. Upon completion of the asset transfer, the Company will recapitalize without any expected impact to its credit quality or ratings.

Q. PLEASE EXPLAIN WHAT IT MEANS TO "RECAPITALIZE" DUKE ENERGY OHIO AND HOW THE COMPANY WILL ACCOMPLISH THIS GOAL.

A. Duke Energy Ohio is the obligor for all of its outstanding debt and it does not have the ability to easily transfer these obligations, or any portion thereof, to another entity, even though significant assets will be transferred. Upon transfer of the non-regulated generation assets to a subsidiary of Duke Energy Ohio, the Company will have to retire debt that is currently on the Company's balance sheet and re-issue it elsewhere in order to maintain levels of debt that are appropriate for Duke Energy Ohio to sustain its current credit quality and ratings. The ability to maintain sufficient equity in the capital structure as well as achieving an acceptable return on equity (ROE) will be critical to helping the Company maintain its credit quality as it progresses through the asset transfer and thereafter.

Q. WHAT RATEMAKING TREATMENT IS BEING REQUESTED IN THIS PROCEEDING AND HOW WILL THE COMPANY'S FINANCIAL OBJECTIVES BE IMPACTED?

A. As explained by Duke Energy Ohio witness Julia S. Janson, Duke Energy Ohio is requesting an overall rate increase of approximately 8.1 percent, equating to an increase in pre-tax revenue requirement of approximately $44.6 million. As part of this request, supported by the analysis and testimony of Duke Energy Ohio witness Dr. Roger Morin, the Company is requesting an allowed ROE of 10.6 percent. The proposed capitalization in this request is comprised of 53 percent equity and 47 percent debt. Approval of the Company's request in this case will support its financial objectives by ensuring timely cash recovery of its prudently incurred costs. Approval of the rate increase in this case is important and necessary to Duke Energy Ohio, whether or not the non-regulated generation assets are transferred.

III. CREDIT QUALITY & CREDIT RATINGS

Q. PLEASE EXPLAIN CREDIT QUALITY AND CREDIT RATINGS, AND HOW THEY ARE DETERMINED.

A. Credit quality (or creditworthiness) is a term used to describe a company's overall financial health and its willingness and ability to repay all financial obligations in full and on time. An assessment of Duke Energy Ohio's creditworthiness is performed by Standard & Poor's (S&P), Moody's Investors Service (Moody's), and Fitch Ratings (Fitch), and results in Duke Energy Ohio's credit ratings and outlook.

Many qualitative and quantitative factors go into this assessment. Qualitative aspects may include Duke Energy Ohio's regulatory climate, its track record for delivering on its commitments, the strength of its management team, corporate governance, its operating performance, and the strength of its service area. Quantitative measures are primarily based on operating cash flow and focus on Duke Energy Ohio's ability to meet its fixed obligations (interest expense in particular) on the basis of internally generated cash and the level at which Duke Energy Ohio maintains debt leverage in relation to its generation of cash. The percentage of debt to total capital is another example of a quantitative measure. Creditors and credit rating agencies view both qualitative and quantitative factors in the aggregate when assessing the credit quality of a company.

Q. WHAT IS THE ROLE OF REGULATION IN THE DETERMINATION OF THE FINANCIAL STRENGTH OF A UTILITY COMPANY?

A. Investors, investment analysts, and credit rating agencies regard regulation as one of the most important factors in assessing a utility company's financial strength. These stakeholders want to be confident that the company operates in a stable regulatory environment that will allow the company to recover prudently incurred costs and earn a reasonable return on investments necessary to meet the demand, reliability, and service requirements of its customers. Important considerations include the allowed rate of return, cash quality of earnings, timely recovery of capital investments, stability of earnings, and strength of its capital structure. Positive consideration is also given for utilities operating in states where the regulatory process is streamlined and outcomes are equitably balanced between customers and investors.

Q. HOW ARE DUKE ENERGY OHIO'S OUTSTANDING SECURITIES CURRENTLY RATED BY THE CREDIT RATING AGENCIES?

A. As of the date of this testimony, Duke Energy Ohio's outstanding debt is rated as follows:

Rating Agency	S&P	Moody's	Fitch
Senior Unsecured Rating	A-	Baa1	A-
Senior Secured	A	A2	A

On July 3, 2012, S&P placed the ratings of Duke Energy and subsidiaries on "CreditWatch" with negative implications as a result of Board actions related to the Progress Energy merger. Moody's and Fitch maintain "stable" outlooks on Duke Energy and subsidiaries.

Q. WHY IS IT IMPORTANT FOR DUKE ENERGY OHIO TO HAVE STRONG INVESTMENT-GRADE CREDIT RATINGS?

A. To assure reliable and cost-effective service, the Company must continuously plan and execute major capital projects. This is the nature of capital-intensive industries like electric and gas utilities. The Company must be able to operate and maintain its business without interruption and refinance maturing debt on time, regardless of financial market conditions. The financial markets have recently experienced periods of extreme volatility, and Duke Energy Ohio must be able to finance its needs throughout such periods. High investment-grade credit ratings provide Duke Energy Ohio with greater assurance of continued access to the capital markets on reasonable terms during periods of extreme volatility. Recent debt market conditions as well as the potential for further financial market turmoil resulting from Europe's sovereign debt crisis continue to illustrate the importance of high investment-grade credit ratings such as the A-/Baa1/A- senior unsecured ratings that Duke Energy Ohio currently enjoys.

Q. WHAT STRENGTHS AND WEAKNESSES HAVE THE AGENCIES IDENTIFIED WITH RESPECT TO DUKE ENERGY OHIO?

A. With respect to the regulated transmission and distribution businesses of Duke Energy Ohio, the rating agencies believe the Ohio regulatory environment generally supports long-term credit quality with timely and sufficient recovery of prudently incurred costs and expenses. S&P assigns a rating to the business risk of Duke Energy's rated companies. In their assessment of business risk, S&P rates Duke Energy Ohio lower than the other entities in the Duke Energy family, as well as most other U.S. Regulated Utilities, due to the impact of competition on the Company's generating assets. Generally speaking, the credit rating agencies have identified the challenges of managing Duke Energy's higher capital expenditure program, prospects for more stringent environmental mandates, and plans for a new nuclear facility among the issues that could affect the credit quality of Duke Energy and its operating utilities. In their January 2012 report on Duke Energy Ohio, Moody's cites among the top credit rating drivers:

- A new three-year ESP that provides some clarity, but will likely result in lower revenues, earnings, and cash flow from the company's currently regulated Ohio coal fired generation assets;
- Currently strong financial metrics that are likely to decline under the ESP; and
- Large capital expenditures over the next several years.

Such comments highlight the importance of this proceeding's outcome in supporting credit quality and the Company's financial objectives.

IV. CAPITAL STRUCTURE AND COST OF CAPITAL

Q. WHAT IS DUKE ENERGY OHIO'S PROPOSED CAPITAL STRUCTURE?

A. As mentioned earlier in my testimony, Duke Energy Ohio's proposed capital structure is comprised of 47 percent long-term debt and 53 percent equity, after making adjustments for certain assets that are related to Duke Energy North America (DENA) and Purchase Accounting. The Company believes this proposed capital structure is the optimal capital structure, as it introduces an appropriate amount of risk due to leverage and minimizes the weighted average cost of capital. Approval of the proposed capital structure will help Duke Energy Ohio maintain its credit quality as it progresses through the transfer of the generation assets and the recapitalization of the balance sheet, as well as to meet its ongoing business objectives.

Q. DOES THE CAPITAL STRUCTURE AS FILED IN THESE PROCEEDINGS REFLECT A VIEW OF DEBT AND EQUITY THAT IS IDENTICAL TO THAT CALCULATED BY THE RATING AGENCIES?

A. In assessing the debt component of capital structure for ratings purposes, the credit rating agencies make additional adjustments to include short-term debt and current maturities of long-term debt and then impute *pro-forma* debt amounts to include in their capital structure calculations for long-term fixed obligations, which they consider to be "debt equivalents." Examples of "debt equivalents" would include certain operating lease obligations, long-term purchased power agreements, and under-funded pension plan obligations. The rating agencies view the Company as having higher leverage as a result of these adjustments, assuming all else is equal.

Q. WHAT IS DUKE ENERGY OHIO'S COST OF EQUITY?

A. Duke Energy Ohio witness Dr. Roger Morin testifies that the Company's cost of equity is 10.6 percent. The Company supports Dr. Morin's analysis and is requesting 10.6 percent as the Company's allowed ROE.

Q. WHAT ROLE DO EQUITY INVESTORS PLAY IN THE FINANCING OF DUKE ENERGY OHIO, AND HOW WILL THE OUTCOME OF THIS CASE IMPACT THESE INVESTORS?

A. Equity investors provide the foundation of a company's capitalization by providing significant amounts of capital, for which an appropriate economic return is required. Duke Energy Ohio compensates equity investors for the risk of their investment by targeting fair and adequate returns, a stable dividend policy, and earnings growth, thereby preserving access to this form of capital. Returns to equity investors are realized only after all operating expenses and fixed payment obligations (including debt principal and interest) of the business have been paid. Because these investors are the last to receive surplus earnings and cash flows, it is their capital that is most at risk if the Company suffers a downturn in business or general financial conditions. For this reason, equity investors require a higher return for their investment. Equity investors expect utilities like Duke Energy Ohio to recover their prudently incurred costs and earn a fair and reasonable return for their investors. The Company's proposal in these proceedings supports this investor requirement.

Q. WHAT EFFECT DO CAPITAL STRUCTURE AND RETURN ON EQUITY HAVE ON CREDIT QUALITY?

Capital structure and return on equity are important components of credit quality. Equity provides cushion and safer returns for debt investors, but is also a more expensive form of capital. The Company seeks to maintain a level of equity in the capital structure that ensures high credit quality, while minimizing the cost of capital. The allowed ROE is a key component in the generation of earnings and cash flows. An adequate ROE helps ensure equity investors receive fair compensation for the capital they have at risk while at the same time helping to protect debt investors. High credit quality creates financial flexibility by providing more readily available access to the capital markets on reasonable terms, and ultimately lower debt financing costs.

Q. DO YOU BELIEVE THAT DUKE ENERGY OHIO'S CAPITAL STRUCTURE HAS AN ADEQUATE EQUITY COMPONENT TO ENABLE DUKE ENERGY OHIO TO ACHIEVE THE COMPANY'S FINANCIAL STRENGTH AND CREDIT QUALITY OBJECTIVES?

A. Yes. Duke Energy Ohio's equity component, as requested in these proceedings, enables it to maintain current credit ratings and financial strength and flexibility. This level of equity enables the Company to tolerate different business cycles while also providing a cushion to the Company's lenders and bondholders. The magnitude of its current and future capital expenditures requirements dictates the need for a strong equity component of the Company's capital structure in order to assure access to capital funding at reasonable terms.

Q. WHAT IS DUKE ENERGY OHIO'S AVERAGE COST OF LONG-TERM DEBT?

A. Duke Energy Ohio's weighted average cost of long-term debt as of March 31, 2012, is 5.32 percent. This long-term debt cost reflects an adjustment to eliminate the influence of the Company's pollution control bonds. The adjustment for pollution control debt assumes that the same amount of debt is necessary to support the capital structure but, because the rates at issue in this proceeding do not involve the Company's generation business, the special interest rate associated with pollution control debt is ignored so that all of the debt for pollution control bonds is assumed to be at a cost equal to the weighted cost of all other long-term debt.

The adjustment to remove the impact of pollution control bonds is the same adjustment made in all of the Company's prior rate cases that were filed after its generating business was deregulated.

V. DUKE ENERGY OHIO'S CAPITAL REQUIREMENTS

Q. WHAT ARE DUKE ENERGY OHIO'S CAPITAL REQUIREMENTS DURING THE 2012 – 2014 TIME PERIOD?

A. Duke Energy Ohio faces substantial capital needs over the next several years in order to satisfy debt maturities, refurbish, replace and upgrade aging infrastructure, and invest greater amounts in energy efficiency. The Company's capital requirement for the regulated business of Duke Energy Ohio is projected to be approximately $1.73 billion during the period of 2012-2014. This amount consists of approximately $955 million in projected capital expenditures and approximately $775 million in debt maturities.

Q. HOW WILL DUKE ENERGY OHIO'S CAPITAL REQUIREMENTS BE FUNDED?

A. Duke Energy Ohio's capital requirements are expected to be funded from internal cash generation, the issuance of debt, and equity funding from Duke Energy. It is important to remember that Duke Energy also has dividend obligations to its shareholders. Duke Energy's corporate dividend policy targets a payout of 65-70 percent of adjusted diluted earnings per share, and its operating subsidiaries are expected to mirror this policy over time.

Q. PLEASE DESCRIBE SUPPLEMENTAL FILING REQUIREMENT (C)(3).

A. Supplemental Filing Requirement (C)(3) is a copy of the prospectus from the most recent common stock offering and bond offering.

Q. PLEASE DESCRIBE SCHEDULES D-1A AND D-1B.

A. Schedule D-1A is a summary showing the calculation of the rate of return on rate base being proposed in this case for Duke Energy Ohio. Schedule D-1B is a similar summary of the rate of return using Duke Energy's capital structure. The accumulated deferred income tax and accumulated deferred investment tax credit balances were provided by Duke Energy Ohio witness Keith G. Butler. The adjustments to the capital structure were provided by Duke Energy Ohio witness Daniel J. Reilly. I sponsor the information being used for the calculation of the debt component and Company witness Dr. Morin provided the rate of ROE.

Q. PLEASE DESCRIBE SCHEDULES D-2A AND D-2B.

A. Schedule D-2A provides details about the short-term debt position for Duke Energy Ohio as of March 31, 2012. Schedule D-2B provides details about the short-term debt position for Duke Energy as of March 31, 2012.

Q. PLEASE DESCRIBE SCHEDULES D-3A AND D-3B.

A. Schedule D-3A provides the details about the long-term debt position and cost of Duke Energy Ohio's long-term debt as of March 31, 2012, which were used to calculate the rate of return. Certain adjustments to the Company's long-term debt were provided by Duke Energy Ohio witness Daniel J. Reilly. Schedule D-3B provides details about the long-term debt position and cost of long-term debt for Duke Energy as of March 31, 2012.

Q. PLEASE DESCRIBE SCHEDULES D-4A AND D-4B.

A. Schedule D-4A is used to provide the cost of preferred stock used to calculate the rate of return; however, this schedule is submitted in blank form because Duke Energy Ohio does not have preferred stock. Schedule D-4B provides similar information for Duke Energy and, like Duke Energy Ohio, there is no preferred stock outstanding.

Q. PLEASE DESCRIBE SCHEDULES D-5A AND D-5B.

A. I sponsor page 3 of Schedule D-5A, which calculates the fixed charge coverage ratio for Duke Energy Ohio for the last ten year historical periods and the test period. Page 3 of Schedule D-5B, which I also sponsor, shows the credit ratings history for several of Duke Energy's rated entities over the last ten years and shows the calculation of Duke Energy's fixed charge coverage ratio over that same time period.

VI. CONCLUSION

Q. WERE SUPPLEMENTAL FILING REQUIREMENT (C)(3) AND SCHEDULES D-1A, D-1B, D-2A, D-2B, D-3A, D-3B, D-4A, D-4B, D-5A and D-5B PREPARED BY YOU OR UNDER YOUR SUPERVISION?

A. Yes.

Q. IS THE INFORMATION IN THE SUPPLEMENTAL FILING REQUIREMENTS AND SCHEDULES YOU SPONSORED ACCURATE TO THE BEST OF YOUR KNOWLEDGE AND BELIEF?

A. Yes.

Q. DOES THIS CONCLUDE YOUR PRE-FILED DIRECT TESTIMONY?

A. Yes.