

**BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of the Application of Vectren)	
Energy Delivery of Ohio, Inc., for Approval)	Case No. 18-0049-GA-ALT
of an Alternative Rate Plan)	

In the Matter of the Application of Vectren)	
Energy Delivery of Ohio, Inc. for Approval of)	Case No. 18-0298-GA-AIR
an Increase in Gas Rates)	

In the Matter of the Application of Vectren)	
Energy Delivery of Ohio, Inc., for Approval)	Case No. 18-0299-GA-ALT
of an Alternative Rate Plan)	

**SUPPLEMENTAL DIRECT TESTIMONY OF
PATRICK C. EDWARDS
ON BEHALF OF
VECTREN ENERGY DELIVERY OF OHIO, INC.**

_____	Management policies, practices, and organization
_____	Operating income
_____	Rate base
_____	Allocations
<u> X </u>	Rate of return (Cost of Common Equity Capital)
_____	Rates and tariffs
_____	Other

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**Supplemental Direct Testimony of
Patrick C. Edwards**

I. INTRODUCTION

Q1. Please introduce yourself.

A. My name is Patrick C. Edwards. I am Vice President and Treasurer for Vectren Energy Delivery of Ohio, Inc. (VEDO or the Company), Vectren Utility Holdings, Inc. (VUHI), and Vectren Corporation (Vectren). My business address is One Vectren Square, Evansville, Indiana 47708.

Q2. Are you the same Patrick C. Edwards who filed Direct Testimony on behalf of VEDO in this proceeding?

A. Yes.

II. PURPOSE AND SCOPE OF TESTIMONY

Q3. What is the purpose of your supplemental direct testimony?

A. This testimony supports the Company's objections to recommendations made by the Staff of the Public Utilities Commission of Ohio (Staff) in its Report of Investigation (Staff Report), specifically as it relates to the Staff adjustment for Return on Equity (ROE).

III. RATE OF RETURN

Objection No. 22: Return on Equity

Q4. Did you provide direct testimony on VEDO's Return on Equity?

A. Not specifically. My direct testimony (VEDO Exhibit 4.0) supported VEDO's capital structure and its weighted cost of capital. VEDO witness Vilbert provided direct testimony (VEDO Exhibit 5.0) on VEDO's requested ROE, and also has submitted

1 supplemental direct testimony in this proceeding in response to the ROE range in the
2 Staff Report.

3 **Q5. Are you familiar with the ROE estimates VEDO has requested and Staff has**
4 **recommended in this proceeding?**

5 A. Yes. VEDO witness Vilbert estimates a range for the cost of equity for VEDO from 10
6 percent to 11 percent, with a recommendation of 10.75 percent. The Staff Report
7 recommends a cost of equity range from 8.80 percent to 9.81 percent.

8 **Q6. Why are you sponsoring additional supplemental direct testimony on ROE?**

9 A. As the Treasurer, I am involved with Vectren's and VEDO's ongoing efforts to attract
10 capital to fund ongoing operations and needed capital investment. I believe additional
11 insight on the effect of authorized ROEs on the investing community would be
12 informative to the Commission, as it determines the Company's ROE and rate of return
13 (ROR).

14 **Q7. Will you comment on the technical return analysis performed by either Dr. Vilbert**
15 **or the Staff?**

16 A. No. My testimony offers a practical point of view relative to attracting capital. As the
17 Treasurer of a publicly traded company, I, with the assistance of the CFO and others,
18 work directly with institutional investors, credit rating agencies, and investment analysts,
19 as VEDO competes for capital (both debt through VUHI and equity through Vectren) in
20 the financial marketplace. Through engaging in this capital attraction process, I am
21 familiar with the qualitative and quantitative information that external financial
22 professionals utilize to evaluate potential investments, as well as their reactions to that
23 information.

1 **Q8. What is the potential effect on the investing community of Staff's recommended**
2 **ROE range in this proceeding?**

3 A. Any ROE authorized by the Commission should recognize the challenges a public utility
4 faces when competing for capital. In my opinion, the ROE recommendation put forth by
5 the Staff does not adequately address these challenges. Investors and lenders, with the
6 guidance of financial analysts and credit rating agencies, will assess the merits of VEDO
7 compared to its peers as they decide where to invest their capital. For Vectren, credit
8 supportive regulatory outcomes that produce a competitive cost of capital with peer
9 companies are critical. The utility's authorized ROE is a highly visible indicator of the
10 company's prospective ability to provide investors with reasonable earnings performance.
11 If the Commission authorizes the Staff's midpoint ROE of 9.305 percent in this
12 proceeding, VEDO would receive an ROR of 7.23 percent, assuming the other elements
13 of VEDO's proposed capital structure were accepted. An ROE of 9.305 percent and an
14 ROR of 7.23 percent would be the lowest current returns amongst the larger investor
15 owned gas utilities in Ohio. At best, the investing community would view the Staff
16 midpoint with pessimism. At worst, efforts to raise capital on VEDO's behalf would be
17 burdened by the unfavorable regulatory outcome.

18 **Q9. What is the importance of the authorized ROE and resulting ROR in this**
19 **proceeding?**

20 A. To fund the operations of VEDO and its affiliates, it will be necessary to compete in the
21 market for both debt and equity capital with regularity over the next five years while the
22 rates set in this proceeding will be in effect. During this five year window, we currently
23 anticipate VEDO and its sister Indiana utilities will require \$3 to \$4 billion in capital
24 expenditures to meet the needs of our customers and continue to provide safe and reliable

1 service. VEDO's portion of these expenditures is upwards of \$600 million. This need
2 compares to VEDO's FERC basis net utility plant balance as of December 31, 2017 of
3 \$725 million.

4 **Q10. How does an authorized ROE affect VEDO's ability to attract capital?**

5 A. Return on equity is important in two ways. First, it significantly defines the investors'
6 financial return opportunity and is easily comparable to other utilities and even other non-
7 utility investment opportunities that compete with VEDO for capital. Second, the
8 investment community places great emphasis on the credit supportive quality of the
9 Company's regulatory environment. Financial analysts rank commissions for this very
10 reason. Vectren's management points to prior constructive regulatory decisions in Ohio
11 to differentiate our operations in discussions with investors, credit rating agencies, and
12 others in the financial community. Certainly, the utility's authorized ROE is a key
13 indicator of regulatory support and regulatory risk.

14 **Q11. Can the authorized ROE and the resulting ROR drive investment decision making?**

15 A. Yes. Because VEDO and Vectren compete for capital, comparisons to other companies
16 are inevitable. Typically, an investor must make an explicit decision to reduce or exit a
17 position in another company in order to invest in VEDO. As such, the motivation to take
18 such action will be driven by expected financial performance, where the authorized return
19 is a key item in the evaluation process.

20 **Q12. Can an entity's size drive investment decision making?**

21 A. Yes. VEDO competes with all utility companies for capital. A core pillar of Vectren's
22 message to existing and potential investors to attract the necessary capital has
23 consistently been constructive regulation linked closely to solid financial returns. For this
24 message to resonate with investors, a solid and competitive financial return earned by

1 each utility subsidiary is paramount. To attract investment that would otherwise naturally
2 flow to larger entities like Duke and Dominion, it is important that VEDO's regulatory
3 outcomes and the regulatory environment in Ohio continue to be constructive and the
4 return VEDO can generate continues to be competitive.

5 **Q13. Do credit rating agencies place great emphasis on base rate outcomes?**

6 A. Yes. Credit rating agencies place great emphasis on rate case outcomes as a part of their
7 evaluation of the regulatory environment. As an example, the model used by Moody's
8 Investor Services to determine the credit rating of a utility company bases 50 percent of
9 that rating on the entity's regulatory framework and ability to recover costs and earn
10 returns. Utilities across the United States are experiencing significant change in cash
11 flows as a result of the implementation of the Tax Cuts and Jobs Act of 2017. Utilities
12 also must significantly invest in utility operations to maintain safety and reliability of
13 services provided. In that environment, any negative change in the amount of authorized
14 return or perceived change in the underpinnings of the regulatory environment could be
15 key contributors for a potential downward adjustment to an entity's credit rating. Such
16 change will increase the cost of capital for that entity and the cost to serve customers.

17 **Q14. Should VEDO's authorized ROE reflect the rising interest rate environment?**

18 A. Yes. The 10-year U.S. Treasury is a key factor in the cost of a utility company's equity.
19 As that rate rises, the cost of our company's equity becomes more expensive. VEDO's
20 cost of debt decreased from 7.02 percent in the 2007 case to 5.07 percent in this case.
21 This decrease in interest expense was a factor in allowing VEDO to operate without a
22 general rate proceeding for a decade—regulatory stability that is viewed favorably by the
23 investing community. For several years however, the investing community has been
24 waiting for long-term interest rates to rise. Based on current data, it appears this rise has

1 begun. As of December 31, 2017, the United States 10-year Treasury yield was 2.4
2 percent. As of October 19, 2018, that rate stands at 3.2 percent, an increase of 80 basis
3 points.

4 **Q15. How do investors view rising interest rates?**

5 A. VEDO's investors bear the risk of rising interest rates. The rate structure including the
6 ROR, once approved, offers no protection against rising interest rates. A rising interest
7 rate environment thus creates uncertainty for the investor and increased risk to VEDO's
8 ability to attract equity capital. Investors always have a choice between debt and equity
9 investments. As interest rates increase on debt, expected returns on equity must adjust as
10 well, or else investors will choose the lower risk investment, *i.e.*, debt. Dr. Vilbert utilizes
11 Treasuries in his ROE determination, and appears to have utilized rates reflective of the
12 current interest rate environment. Dr. Vilbert, however, also discusses in greater detail the
13 forecasted trend of increases in rates. In my opinion, the ROE estimate recommended by
14 Dr. Vilbert will counteract the risk and uncertainty caused by the anticipated rising
15 interest rates.

16 **Q16. Are you aware of the Rate of Return (ROR) that the Commission approved in**
17 **VEDO's last rate case, Case Nos. 07-1080-GA-AIR and 07-1081-GA-ALT?**

18 A. Yes. The Commission's January 7, 2009 Order adopted the September 8, 2008 Joint
19 Stipulation, in which parties agreed that VEDO should receive an ROR of 8.89 percent.
20 In this proceeding, VEDO has requested a reasonable and competitive ROR of 7.97
21 percent based on its proposed capital structure and cost of debt and using Dr. Vilbert's
22 ROE recommendation of 10.75 percent. In contrast, the Staff Report recommends a ROR
23 in the range of 6.97 percent to 7.49 percent, with a midpoint of 7.23 percent.

1 **Q17. How does an ROR of 7.97 percent requested in this rate case compare with RORs**
2 **approved for other investor owned gas utilities in Ohio?**

3 A. In Case No. 07-0829-GA-AIR (October 15, 2008 Order), the Commission approved a
4 ROR of 8.49 percent for Dominion East Ohio. In Case No. 08-0072-GA-AIR (December
5 3, 2008 Order), the Commission approved a ROR of 8.12 percent for Columbia Gas of
6 Ohio, Inc. In Case No. 12-1685-GA-AIR (November 13, 2013 Order), the Commission
7 approved a ROR of 7.73 percent for Duke Energy Ohio.

8 **Q18. Amongst the larger investor-owned gas utilities in Ohio, even if the Commission**
9 **authorized the high point of the Staff Report ROE range in this proceeding, would**
10 **VEDO's ROR go from the highest to the lowest in the state?**

11 A. Yes.

12 **IV. CONCLUSION**

13 **Q19. Does that conclude your prepared supplemental direct testimony?**

14 A. Yes.

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing document was served by electronic mail to the following persons on this 7th day of November, 2018:

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Summary: Exhibit 4.1 - Supplemental Direct Testimony of Patrick C. Edwards electronically filed by Ms. Rebekah J. Glover on behalf of Vectren Energy Delivery of Ohio, Inc.