



**Public Utilities  
Commission**

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June 6, 2019

Docketing Division  
Public Utilities Commission of Ohio  
180 East Broad Street  
Columbus OH 43215

RE: *In the Matter of the Application of Duke Energy Ohio, Inc., for Authority to (1) Issue and Sell First Mortgage Bonds, Unsecured Debt, Long-Term Notes, (2) Enter Into Capital Lease Obligations, and (3) Enter Into Interest Rate Management Agreements*

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Dear Docketing Division:

Enclosed please find Staff's Review and Recommendation in regard to the application of Duke Energy Ohio, Inc. for authority to issue securities as stated above in Case No. 19-0637-GE-AIS.

Doris McCarter  
Division Chief, Capital Recovery and Financial Analysis  
Rates and Analysis Department  
Public Utilities Commission of Ohio

Enclosure

Cc: Parties of Record

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BEFORE  
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Duke	)	
Energy Ohio, Inc., for Authority to (1) Issue	)	
and Sell First Mortgage Bonds, Unsecured	)	Case No. 19-637-GE-AIS
Debt, Long-Term Notes, (2) Enter Into	)	
Capital Lease Obligations, and (3) Enter Into	)	
Interest Rate Management Agreements.	)	

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**Staff Review and Recommendation**

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**APPLICATION DESCRIPTION**

On July 25, 2018, the Public Utilities Commission of Ohio ("Commission") authorized Duke Energy Ohio Inc. ("Duke Ohio") to issue \$900 million in long-term debt securities, and other items ("Current Authority"). Duke Ohio's Current Authority expires on June 30, 2019.<sup>1</sup> Duke Ohio has issued \$800 million of first mortgage bonds, in two series, under the Current Authority.<sup>2</sup>

On March 29, 2019, Duke Ohio filed an application and exhibits ("Application") with the Commission, pursuant to Sections 4905.02 and 4905.03 of the Ohio Revised Code. The Application seeks the authority to: (a) sell and/or issue up to \$600 million principal amount of first mortgage bonds ("Bonds"), senior unsecured debt securities or junior subordinated debt securities (collectively "Debentures"), or other long-term unsecured indebtedness including commercial paper classified as long-term ("Long-Term Notes"), or any combination thereof (collectively, "Debt Securities"); (b) enter into additional capital lease obligations ("Capital Leases") up to \$100 million in principal amount; and (c) enter into Interest Rate Management Agreements ("Interest Agreements") to manage the interest costs of its financial obligations. Duke Ohio specifies a time period that ends June 30, 2020, for its Application.

The Application sets out the parameters Duke Ohio has developed to issue the proposed long-term debt. They include: (a) a maturity of up to 60 years; (b) redemption premiums, if any, are to be established in negotiation with placement agents; (c) commissions are not to exceed 3.5 percent

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<sup>1</sup> See *In the Matter of the Application of Duke Energy, Ohio, Inc., for Authority to Issue and Sell First Mortgage Bonds, Unsecured Debt, Long-Term Notes; Enter Into Capital Lease Obligations; and Enter Into Interest Rate Management Agreements*, Case No. 18-0238-GE-AIS, Finding and Order (July 25, 2018) (*Duke 2018 AIS*)

<sup>2</sup> *Duke 2018 AIS*, Report of Issuance (January 8, 2019)

of the principal amount; (d) a price to purchasers no greater than 102 percent nor less than 98 percent of the principal amount, plus accrued interest; (e) if a fixed coupon, a coupon rate that does not exceed 7 percent; and (f) if a floating rate coupon, a coupon that does not exceed the London Interbank Offered Rate for U.S. dollar deposits ("USD LIBOR") by more than 400 basis points nor exceed 7 percent at issuance.

In regards to the proposed Capital Leases, Duke Ohio identifies the parameters as: (a) a maximum term of 40 years; and (b) a lease cost comparable to other financing alternatives with similar terms, not to exceed 9 percent.

Lastly, Duke Ohio seeks authority to utilize Interest Agreements to manage costs associated with its debt. The Application identifies products commonly used in capital markets including interest rate swaps, options, and futures. The Interest Agreements are to be entered into with highly rated counterparties for a fixed period and stated notional amount.

## **REVIEW AND ANALYSIS**

Duke Ohio intends to use the proceeds from the sale of its Debt Securities for: (a) the acquisition of property; (b) construction, completion, extension, or improvement of facilities; (c) management of its capital structure, including refinancing of securities; and (d) the discharge or lawful refunding of its obligations or reimbursement of its treasury, in part, for monies expended for such purposes; and (e) other general corporate purposes. It is anticipated that Duke Ohio will continue to demonstrate financial metrics that are appropriate for its current ratings (Baa1 by Moody's, outlook: Stable; A- by Standard & Poor's, outlook: Stable) despite the added interest expense and debt used to fund these outlays.

Duke Ohio is in a period of significant capital spending as transmission and distribution assets are upgraded. In 2019 and 2020, Duke Ohio anticipates capital expenditures of approximately \$637 million and \$651 million, respectively. During these two years, in aggregate, the potential capital financing requirements exceed \$1.2 billion. Duke Ohio anticipates that the requested authority for Debt Securities and Capital Leases, in addition to cash flows from operations, will provide sufficient funding for its capital plan. There are no refinancings or debt maturities expected during the period ending June 30, 2020.

The Application identifies 7 percent as a ceiling on the interest rate that Debt Securities may be issued. It is recognized that current U.S. Treasury rates, plus credit spreads, are below the requested 7 percent maximum. In fact, Duke Ohio issued 30-year, \$400 million, first mortgage bonds with a fixed coupon rate of 4.30 percent in January 2019. It simultaneously issued 10-year, \$400 million first mortgage bonds with a 3.65 percent fixed coupon. The intent of the parameters is not to influence the pricing of securities, but rather to provide a reasonable assurance that Duke Ohio can access capital in all market conditions. Thus, Staff anticipates that the actual terms of any Debt Securities will reflect a coupon rate (and resulting financing cost) that is much lower than that described by the Application.

The Capital Leases are to have terms and structures similar to other forms of debt financing; under certain circumstances, they allow Duke Ohio to acquire property at a lower overall cost. Duke Ohio also seeks authority to enter into Interest Agreements to manage its interest costs and interest rate risk. In general, this authority does not impact the capitalization of Duke Ohio as there are no proceeds or new obligations created as a result of participating in them. Duke Ohio was previously granted authority to enter into Capital Leases and Interest Agreements.<sup>3</sup>

The following table summarizes the pro forma capitalization of Duke Ohio giving effect to the proposed long-term debt issuance.\*

	Actual 3/31/2019 (\$ MMs)	(%)	Pro Forma (\$ MMs)	(%)
Long Term Debt	\$ 2,409	48%	\$ 3,009	54%
Common Equity	\$ 2,594	52%	\$ 2,594	46%
Total Capitalization	\$ 5,003	100%	\$ 5,603	100%

\* Long-term debt excludes current maturities and equity has been adjusted to remove the impact of net purchase accounting.

As shown on a pro forma basis, the proposed financing will increase the use of debt in Duke Ohio's capitalization. While Duke Ohio manages to its approved regulatory capital structure, its debt/equity ratio will vary over time, depending on the timing and size of debt issuances, seasonality, and other influences.

## **RECOMMENDATION**

Upon review of the Application and supporting documentation, Staff believes Duke Ohio's request appears reasonable and recommends approval with the following conditions:

1. The authorization to issue Debt Securities and enter into Capital Leases within the parameters set forth in the Application in no way relieves Duke Ohio of its responsibility to negotiate and obtain the best competitive market terms available.
2. In the event that Duke Ohio enters into interest rate management agreements, it will report, in this case docket, the terms and full particulars to the Commission within 30 days of executing the transaction(s).

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<sup>3</sup>Duke 2018 AIS, Finding and Order (July 25, 2018)

3. Duke Ohio shall file a summary report, in this case docket, within 30 days of issuing any Debt Securities under the authority granted in this case. The report shall summarize the principal amount, interest rate and type of security issued; the other terms and full particulars of the Debt Securities including a description of any collateral required, issuance expenses, any discounts or premiums, any credit enhancements, and other pertinent repayment terms; and the use of proceeds from the Debt Securities in broad categories.
4. Duke Ohio shall file a summary report, in this case docket, within 30 days of entering into Capital Leases under the authority granted in this case. The report shall summarize the principal amount of lease, lease term, lease cost, and other terms and full particulars of the Capital Lease.