BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Duke Energy Ohio, Inc., for the Establishment of a Charge Pursuant to Revised Code Section 4909.18.	))))	Case No. 12-2400-EL-UNC
In the Matter of the Application of Duke Energy Ohio, Inc., for Approval to Change Accounting Methods.	)))	Case No. 12-2401-EL-AAM
In the Matter of the Application of Duke Energy Ohio, Inc., for the Approval of a Tariff for a New Service.	)))	Case No. 12-2402-EL-ATA

DIRECT TESTIMONY OF

JULIE M. CANNELL

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: Financial objectives and the perspective of investors

March 1, 2013

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I. INTRODUCTION AND PURPOSE

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Julie M. Cannell, and my business address is P.O. Box 199, Purchase, New York 10577.

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

A. I am the President of my own advisory firm, J.M. Cannell, Inc.

Q. PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND PROFESSIONAL EXPERIENCE.

A. My firm, J.M. Cannell, Inc., provides investor-related advisory services to electric utility companies and other firms and organizations with an interest in the industry. Prior to establishing my firm in February 1997, I was employed by the New York-based investment manager, Lord Abbett & Company, from June 1978 to January 31, 1997. During my tenure with Lord Abbett, I was a securities analyst specializing in the electric utility and telecommunications services industries; portfolio manager of America's Utility Fund, an equity utility mutual fund, for which Lord Abbett was a sub-advisor; portfolio manager of numerous institutional equity portfolios; and co-director of Lord Abbett's Equity Research Department.

My educational credentials include a B.A. from Mary Baldwin College, an M.Ln. from Emory University, and an M.B.A. from Columbia University. I am also a Chartered Financial Analyst (C.F.A.). I have been a member of the Wall Street Utility Group, an organization of security and credit rating analysts having an expertise in the utility industry, for over thirty years.

Q. ON WHOSE BEHALF ARE YOU TESTIFYING?

A. I am testifying on behalf of Duke Energy Ohio, Inc. (Duke Energy Ohio or Company).

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

A. No. This is my first appearance before the Public Utilities Commission of Ohio (PUCO or Commission).

Q. HAVE YOU PREVIOUSLY TESTIFIED ON THE PERSPECTIVE OF INVESTORS BEFORE OTHER UTILITY REGULATORY COMMISSIONS?

A. Yes, I have. I have submitted pre-filed testimony on behalf of investor-owned utilities before Public Service Commissions and Public Utility Commissions in Arizona, Arkansas, Colorado, Connecticut, Delaware, the District of Columbia, Kansas, Kentucky, Louisiana, Maryland, Massachusetts, Minnesota, Missouri, Nevada, New Jersey, New York, Oklahoma, Pennsylvania, Rhode Island, South Carolina, Texas, Vermont, Virginia, Washington and Wisconsin. The details of my participation in regulatory proceedings are provided in Exhibit JMC-1.

Q. HAVE YOU HAD ADDITIONAL REGULATORY EXPERIENCE?

A. Yes. As a consultant to the Edison Electric Institute (EEI), I was extensively involved between 2004 and 2009 in an ongoing initiative geared toward fostering and improving communications between state regulators and the investment community. This effort was centered on a series of forums held throughout the United States bringing together these two constituencies, sponsored by EEI and facilitated by Gee Strategies' president, Robert Gee, former chairman of the Texas Public Utilities Commission. In addition to helping structure these dialogues, my role was to moderate panel discussions of equity and debt security analysts.

I have also conducted several studies of investor perceptions of regulatory issues. Further, I have written articles addressing the implications for utilities and state regulators of various topical issues, including the current electric industry capital expenditure cycle, the financial crisis of recent years, and best practices of environmental cost recovery.

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

A. I will address the perspective of investors in regard to Duke Energy Ohio's request for cost-based capacity pricing based upon the state compensation mechanism implemented by the Commission on July 2, 2012; deferral of the difference between costs collected under the state mechanism and the final zonal capacity price it is currently receiving from PJM; and an attendant new tariff to collect deferred amounts, initially to be set at zero.

Q. WHAT IN YOUR EXPERIENCE ALLOWS YOU TO PROVIDE TESTIMONY ABOUT INVESTORS' PERSPECTIVES AND EXPECTATIONS?

A. As a securities analyst, I specialized in the electric utility industry and the individual companies comprising it. And as a portfolio manager, I applied that knowledge, along with investment fundamentals, in making investment decisions on behalf of institutions and individual investors. My experience has given me familiarity with the information and tools that investors use in making decisions.

Q. AS AN ANALYST OR PORTFOLIO MANAGER, DID YOU FOLLOW THE COMPANY?

A. Yes, I did. Duke Energy Corporation (Duke Energy) and its predecessor companies, Duke Power Company and Cinergy Corporation (Cinergy), were frequently held in Lord

Abbett's equity portfolios and in America's Utility Fund. My analysis of Cinergy included a focus on utility issues in Ohio, including the regulatory environment.

II. DISCUSSION

Q. WHAT ARE THE GENERAL CATEGORIES OF INVESTORS IN CORPORATIONS?

A. Corporations are funded by both equity investors, who hold stock and thereby own a share in the entity, and debt investors, who loan money to the company. My testimony will address the equity investors' role. Duke Energy Ohio witness Stephen G. De May discusses, among other things, debt investors.

Q. WHAT IS THE ROLE OF EQUITY INVESTORS IN REGARD TO ELECTRIC UTILITIES?

A. Utilities have an ongoing need for capital to fund their day-to-day business as well as to make investments in infrastructure and other assets. As I mentioned, this capital takes two main forms: equity and debt. Equity investors provide capital to corporations such as the Company's parent, Duke Energy Corporation (Duke Energy) by purchasing common stock sold by the company. While equity can be in the form of either common or preferred stock, my testimony focuses on common stock, which is substantially more prevalent in today's market.

Q. DO EQUITY INVESTORS INVEST DIRECTLY IN A SUBSIDIARY OF A UTILITY HOLDING COMPANY?

A. No. Wholly owned subsidiary companies such as Duke Energy Ohio only sell debt securities; they do not issue equity. On the equity side, an investor purchases stock in the utility holding company, such as Duke Energy. The holding company is then in a position to determine how best to spend its capital, including investment in its subsidiaries.

Q. WHY DO INVESTORS TAKE EQUITY POSITIONS IN COMPANIES?

A. The answer is certainly different for different investors, and I will address investors' goals in more detail, later in my testimony. However, as a common theme, equity investors typically hope to make money, either through the receipt of dividends and/or by the appreciation of the stock price. This holds true, regardless of whether we are talking about the investor owning stock in the holding company or about the holding company's investments in its subsidiaries. Just like an individual or institutional investor, the holding company seeks to earn a return.

Q. WHY ARE EQUITY INVESTORS IN A HOLDING COMPANY CONCERNED ABOUT OPERATIONS OF A WHOLLY OWNED SUBSIDIARY UTILITY SUCH AS DUKE ENERGY OHIO?

A. Although an outside equity investor has its direct investment in the holding company, like Duke Energy, such an investor indirectly gains an interest in all the subsidiaries of the parent, including Duke Energy Ohio. In considering purchasing such common stock, equity investors evaluate the prospects of all the parent's holdings. A positive outlook for one subsidiary could encourage investment in the parent company; conversely, poor expectations regarding a subsidiary company could make an equity investment in the parent inadvisable.

Q. PLEASE EXPLAIN WHY THE VIEWS OF EQUITY INVESTORS REGARDING AN ELECTRIC UTILITY'S STOCK ARE IMPORTANT TO THE UTILITY AND ITS CUSTOMERS.

A. Electric utilities are in the business of providing their customers with safe, reliable and efficient service. This requires extensive investment in generation, distribution and transmission infrastructure, which makes the electric utility business capital-intensive. Investors provide the capital necessary to maintain and expand a utility's infrastructure, which in turn enables utilities like Duke Energy Ohio to provide safe, reliable and efficient service to customers.

The terms on which the Company is able to obtain that capital have a direct and measurable impact on customers and the amounts they pay for electric service.

Q. PLEASE PROVIDE AN EXAMPLE.

A. If equity investors believe that the return they are offered for a given investment is too low in light of the risk involved, they will either sell their stock in a company or elect not to purchase the stock, which generally drives the stock price down. Although lower stock prices would appear at first blush to be of concern only to investors, they also affect customers. This is because a reduction in the stock price increases the return investors require on the stock, which increases costs to ratepayers. When a utility has to go to the equity markets to obtain capital, a low stock price requires it to issue more shares of stock to obtain the same amount of money than it would have received for fewer shares if the per share price had been higher. The resulting increase in the number of shares outstanding requires more dollars to be expended toward dividends, resulting in less retained earnings for reinvestment in the company.

The corollary is that, when investors believe that they are investing in a company where regulation is fair and consistent and provides reasonable assurance that prudently incurred costs will be fully recovered, those investors require a lower rate of return on their capital. When equity investors demand less for their capital, utility rates remain lower and utilities have more ready access to the capital markets. Thus, a utility and its customers have a shared interest in meeting the expectations of investors.

Regulators share this interest as well. A regulatory environment that investors consider to be consistent, fair, balanced, and predictable will result in a lower cost of capital for utilities in that jurisdiction. That in turn will decrease the cost of electric power for customers.

Q. ARE YOU SUGGESTING THAT INVESTORS SHOULD DICTATE THE COMMISSION'S DECISIONS?

A. Not at all. I realize that the PUCO must apply the law to the facts that are presented to it and that its goal is to balance the interests of investors, ratepayers, and the companies under its jurisdiction. I understand that the Commission has clearly stated that its mission and responsibility include protection of consumers' access to adequate, safe, and reliable utility service as well as protection of the utilities' financial integrity.[1]

Q. HOW HAS THE RISK OF INVESTING IN ELECTRIC UTILITIES CHANGED IN RECENT YEARS?

A. The industry is now in a period of significant capital expenditures. To fund these expenditures, utilities will be more active in capital markets and, therefore, will be more exposed to the risks and uncertainties in those markets.

Electric utilities will also be more exposed to regulatory risks, since a significant expansion of capital spending by those companies usually results in rate proceedings to

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[1] Commission Mission Statement, http://www.puco.ohio.gov/puco/index.cfm/about-the-commission/mission-and-commitments/, Feb. 25, 2013; *In the Matter of the Commission Review of the Capacity Charge of Ohio Power Company and Columbus Southern Power Company*, Case No. 10-2929-EL-UNC, Opinion and Order, at pg. 22 (Jul. 2, 2012), Entry on Rehearing, at pg. 28 (Oct. 17, 2012).

recover the costs associated with that capital. As a result, regulatory exposure has become a key focus for investors as utilities face a series of rate cases.

It is because of these increased risks that investors no longer perceive electric utilities as a group as being the "safe havens" they once were.

Q. IN ADDITION TO INDUSTRY RISKS, DOES DUKE ENERGY OHIO ALSO FACE SPECIFIC RISKS?

A. Yes, it does. The most significant risk confronting the Company at the present time is the negative return being earned on its generation assets. This negative return, especially if it is not consistent with other, similarly situated Ohio utilities, jeopardizes Duke Energy Ohio's ability to access low-cost capital and thereby its ability to invest in Ohio.

Q. WHAT GOALS LEAD INVESTORS TO INVEST IN ELECTRIC UTILITIES?

A. Historically, electric utilities have been regarded as investment vehicles that provide stable performance through the ups and downs of market cycles and changing economic conditions. In addition, the reliability of electric utilities' earnings streams permitted most of the companies to continue to pay regular dividends during both good and bad economic cycles. For investors with a need for regular cash income, the prospect of regular dividends has been an important consideration in making a decision to invest in electric utility stocks.

Based on these factors, investors have traditionally viewed electric utility stocks as bond substitutes. As a result, just like bonds, electric utility stocks as a group have tended to move closely in line with the direction of interest rates, but in an inverse relationship. That is, utility stock prices rose when interest rates fell, and vice versa. These factors made electric utilities a preferred investment during economic slowdowns or recessions and owning them was a way of balancing the risks in a portfolio of stocks that included stocks in more volatile industries.

Q. HAVE INVESTORS' GOALS FOR UTILITY INVESTMENTS CHANGED IN RESPONSE TO INCREASED RISKS?

A. No. Investors' goals for electric utility investments have not fundamentally changed. They still look to electric utilities primarily as defensive investments, and still look for stable performance and regular dividends as the reason to invest in electric utilities. But investors also understand that the investment risk in electric stocks has risen significantly, and their expectations of returns have changed accordingly.

In the end, investors have a very large universe of stocks from which to select; with few exceptions, they have no requirement to own electric utility stocks. To the extent that they do invest within the utility sector, investors must be discriminating in their stock selection. As a result, utilities with strong financial metrics operating in constructive regulatory environments will have stronger investment appeal than utilities with weak metrics and less favorable regulation.

Q. WHO ARE TYPICAL INVESTORS IN UTILITY STOCKS?

A. There are two kinds of investors: individuals, who generally seek stability and income from their utility holdings, and institutions, which generally seek total return (*i.e.*, price appreciation plus dividend income) from their utility investments.

Q. PLEASE SAY MORE ABOUT INSTITUTIONAL INVESTORS. HAS THE INVESTMENT INDUSTRY ITSELF CHANGED IN RECENT YEARS?

A. Yes. In recent years, institutional investors and hedge funds have grown dramatically in the amount of capital they control. This growth has had a significant impact on the speed with which the market reacts to unfavorable developments. It has led the market to be much more reactive and much less forgiving than it may have been in the past. In the context of a regulatory decision, investors will not necessarily wait, as they would have in the past, to see how the ramifications of a decision might play out. Rather, they simply sell their shares if a regulator's decision runs counter to their expectations.

Q. WHY ARE INSTITUTIONAL INVESTORS OF SUCH IMPORTANCE GENERALLY?

A. Because of the sheer size of their investment positions, institutions can influence the course of individual securities, and sometimes can move the market as a whole. Institutional investors include financial institutions such as various types of public retirement funds, mutual funds, investment companies, insurance companies, and commercial and investment banks. They approach the investment selection process from the standpoint of a portfolio. An investment portfolio is a collection of stocks selected to achieve the highest possible return within a commensurate level of risk. Therefore, institutional investors keep electric utilities in their portfolios only when such stocks contribute to achieving the desired risk/return relationship.

It should be remembered that, generally, the customers of institutional investors are individuals and it is they who ultimately gain or suffer loss from changes in the value of the institution's investments. Anyone who has a stake in a retirement plan, owns a mutual fund, has a trust fund, or pays insurance premiums, for example, is directly or indirectly a client of an institutional investor. The individuals who make the decisions concerning these investments, however, are paid money managers, and how they see their responsibilities to the clients they serve, and the way that their performance is judged, have a great deal to do with how they react to developments in the market.

Q. WHY ARE INSTITUTIONAL INVESTORS IMPORTANT TO THE COMPANY?

A. Institutional investors today hold approximately half of parent company Duke Energy's total common shares. Such investors warrant significant attention due to their ability to change dramatically the market for the parent shares. Because institutional investors own large blocks of shares relative to the volumes typically traded, their activity in moving in or out of a company's shares is often noticeable as a significant change in the price and volume of shares being traded for a company. This change may be picked up by other institutional investors, by the investment community in general, and eventually by individual investors. These other entities will then look to see what is driving this trend in the stock and whether the trend is likely to continue or disappear. If they see support for the trend, they may follow the lead of the firms that initially began to move the market, and by following the leaders, the late movers may further strengthen the trend.

Q. WHY MIGHT AN INSTITUTIONAL INVESTOR CHOOSE NOT TO HOLD INVESTMENTS IN A PARTICULAR ELECTRIC UTILITY?

A. Several factors might be drivers. First, institutional investors have fiduciary responsibilities. For example, managers of pension assets fall under Federal Employee Retirement Income Security Act of 1974 (ERISA) laws, which mandate that a portfolio manager's decisions meet the so-called "prudent man" standard. That is to say, he or she is expected not to make investment decisions that are unduly risky or to retain stocks that are unduly risky given the investment goals of the portfolio and the function of the stock within it.

In addition, institutional investors have performance pressures. It is not enough for stocks in a portfolio simply to increase in value. Relative performance is what counts. Investment performance is gauged against the returns earned by a market proxy (such as the S&P's 500 Index) or a peer group of investments (*i.e.*, those with a similar style, such as value, growth, growth & income, small cap, etc.). Mutual fund rating organizations such as Morningstar track and publicize the relative performance for mutual funds, while various pension consultants perform the same service for their client organizations.

Q. WHAT HAPPENS WHEN AN INSTITUTIONAL INVESTOR UNDERPERFORMS?

A. The results can vary, but, eventually, underperformance will result in lost business and personnel changes. Mutual fund shareholders can sell their fund shares. A pension plan sponsor can fire the professional investor or reduce the assets under its investor's management. And, of course, poor performance also disadvantages the individual who has entrusted his monies to the institution for management.

Q. HOW LONG A PERIOD DOES AN INSTITUTIONAL INVESTOR HAVE BEFORE PERFORMANCE BECOMES AN ISSUE?

A. Again, it can vary. But there is little argument that institutional investors no longer have the luxury of a long time horizon in which to show performance. Investors need and want results. And, with the public visibility that investment results now have (through organizations such as Morningstar and the various pension consultants) and the resulting performance pressure, most investment organizations are now operating with a much shorter time horizon than in years past. Generally speaking, a long investment time horizon today can be as short as 12-18 months. So, a stock that is unlikely to perform within the prescribed time horizon is usually not attractive for purchase or continued investment by an institutional investor.

Q. WHAT DOES THIS MEAN FOR INVESTMENTS IN REGULATED UTILITIES SPECIFICALLY?

A. This shortened time frame means that if there is bad news, institutional investors are more likely to react quickly. In the instance of a rate proceeding, these investors are unlikely to wait to see what the outcome of the next rate decision will be. That would represent an opportunity cost to them. Rather, institutional investors would be more prone to sell their shares on the news of an adverse regulatory outcome. As discussed earlier, this would not be good for customers either, due to higher debt costs and less retained earnings for reinvestment.

Q. WHY IS THE PERCEPTION OF REGULATORY CLIMATE OF SUCH IMPORTANCE TO INVESTORS?

A. Equity investors today still seek companies that can offer stability in earnings and dividends. The ability to pay dividends and sustain credit ratings is directly related to the consistency and sufficiency of a utility's earnings, which depend in large part on how the utility is regulated and managed. Compromised quality or strength of a company's earnings or cash flow streams can lead to reduced stock price valuations or credit downgrades. If there is uncertainty about whether regulation will allow a utility the opportunity to earn a reasonable return in future years, then that lack of predictability will lead investors to avoid holding investment positions in the utility, all other things being equal.

As a result, investors selecting electric utility stocks today place a very high value on consistent, balanced, and constructive regulation. And, with the proliferation of rate case filings underway in the industry, the quality of regulation is receiving increased investor scrutiny.

Q. IN YOUR EXPERIENCE AS AN ANALYST AND PORTFOLIO MANAGER, COULD A PERCEIVED CHANGE IN A COMPANY'S REGULATORY CLIMATE AFFECT YOUR INVESTMENT OPINION?

A. Absolutely. During my tenure as an institutional investor, a utility's regulatory environment was a critical factor in my assessment of its investment attractiveness. An adverse regulatory decision could be a key determinant in my recommendation or decision to sell a stock already owned or not to make an investment in one under consideration.

Q. HOW DO INVESTORS VIEW STATE REGULATION CURRENTLY?

A. Because the earnings power of an enterprise is the basis for investment, the consistency, predictability, and fairness of state regulatory policies are critical concerns to investors. From an investor's perspective, each regulatory proceeding introduces a period of uncertainty for a utility. In the current case, for example, the Commission's decision will directly impact the level of earnings for Duke Energy Ohio for the next several years. In other words, the utility's future earnings power is thrown into question until the case is decided.

Q. INVESTORS UNDERSTAND THAT UTILITIES HAVE A REGULATORY COMPACT WITH THEIR REGULATORS. PLEASE EXPLAIN WHAT IS MEANT BY THAT.

A. The regulatory compact means that utilities will take the risk to invest in the infrastructure and assets needed to provide safe, reliable and efficient electric service, and that regulators will support that investment by providing timely recovery of costs, reasonable returns on prudently invested capital, and regulatory treatment that is fair, predictable and balanced. It does not involve favoring any one group of interested parties in the regulatory process over others, but recognizes the key relationship between investment of capital by the utility, and the need for recovery of operating costs, capital and returns to support prudent investment.

Q. PLEASE DISCUSS EQUITY INVESTORS' GENERAL VIEWS OF REGULATION.

A. One of the key factors equity analysts use to evaluate the quality of a regulatory climate is the consistency of a commission's decisions. Investors value certainty and predictability; a lack of consistency in a commission's actions or decisions serves to increase the investment risk associated with a utility. Where there is a predictable track record of regulatory decisions and actions, investors are able to anticipate reliably the future actions of a commission. That reduces risk and supports reasonable valuations – *i.e.*, the market supports a higher price for the company's stock and a lower interest rate on bonds, which decreases a company's cost of capital.

In a study I prepared in 2005 for the EEI on investors' perceptions of state regulation,[2] respondents were asked to cite the regulatory factors they felt characterized a constructive environment, as well as those that characterized a non-constructive environment. On the positive side of the ledger, one of the most important considerations for investors was a regulatory climate that is "fair, stable, predictable, and consistent."[3]

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[2] J.M. Cannell, Inc., State Utility Regulation: An Assessment of Investor Perceptions. Prepared for the Edison Electric Institute. August 2005.

[3] *Id.*, pp. 26-30.

Conversely, a non-constructive regulatory environment was one that is deemed "arbitrary, inconsistent, politically motivated, and demonstrating no awareness of economic realities." In the words of one analyst, such an environment is "regulatory purgatory."[4]

Q. HAVE INVESTORS OFFERED EVALUATIONS OF OHIO REGULATION RELATIVE TO OTHER STATE COMMISSIONS?

A. Yes. Regulatory Research Associates (RRA) has ranked the PUCO from an investor perspective. In its most recent quarterly evaluation of state regulatory commissions, RRA accorded Ohio regulation an "Average-2" rating, a ranking the Commission has held since April 16, 2012.[5] There are three tiers to RRA's ranking scheme: Above Average, Average, and Below Average, with a numeric designation of 1, 2, or 3 (with 1 being the strongest) within the principal rating category employed to indicate relative strength therein. The regulatory firm notes:

> The evaluations are assigned from an investor perspective and indicate the relative regulatory risk associated with the ownership of securities issued by the jurisdiction's electric, gas, and telephone utilities. Each evaluation is based upon our studies of the numerous factors affecting the regulatory process in the state, and is changed as major events occur that cause us to modify our view of the regulatory risk accruing to the ownership of utility securities in that individual jurisdiction.[6]

In its profile of the PUCO, RRA stated:

> While we consider Ohio regulation to be relatively balanced, we note that over the last few years there has been significant uncertainty concerning the future direction of electric industry restructuring and the determination of generation pricing. Legislation enacted in 2008 and subsequent PUC action, however, has provided some clarity with regard to the pricing

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4 *Id.*

5 Regulatory Research Associates, "State Regulatory Evaluations." January 2013.

6 *Id.*

> framework for the power provided to standard offer customers. As a result, and given the existence of relatively low market prices for power, there has been a clear shift toward market-based pricing for standard-service-offer power requirement – the most recent electric security plans approved for the electric utilities have included the transfer of generation to unregulated subsidiaries and periodic power auctions by the utilities. … In April 2012, in order to maintain balance in our ranking system, we lowered the ranking of Ohio regulation to Average/2 from Average/1. (Section updated 4/30/12)

Q. DOES ANY OTHER FIRM PROVIDE REGULATORY RANKINGS?

A. Yes, Barclays Capital does.

Q. PLEASE ADDRESS BARCLAYS' EVALUATIONS.

A. Like RRA, Barclays assesses state commissions from an investor perspective, utilizing six criteria: elected versus appointed; rules mechanism; allowed ROEs; settle versus litigate; rate levels; and subjective investor friendliness rating. Barclays, which holds the view that "positive and constructive regulation reinforces good utility performance and perception," structures its rankings on a 5-tier scale, with Tier 1 representing the lowest cost of capital and Tier 5, the highest cost of capital. Ohio falls in Tier 4, ranking 34th among the included forty-nine states. It bears mention that the jurisdiction was slotted in Tier 3 in Barclays' evaluation of the previous year.[7]

Q. DOES BARCLAYS OFFER FURTHER INSIGHT TO ITS VIEWS OF REGULATION?

A. Yes. The firm believes that constructive regulation brings together the interests of customers and shareholders.

> We believe that customer and shareholder interests are aligned through regulation. This is the result of a feedback loop by which utilities that keep prices relatively low, and service and reliability relatively high, receive constructive regulatory outcomes. In turn, that company enjoys a

[7] Barclays Capital. "Extra Innings." July 16, 2012.

> lower cost of capital, and can afford the investment necessary to keep prices low and reliability high.

Q. WHY ARE REGULATORY RANKINGS IMPORTANT TO INVESTORS?

A. Investors make decisions within a relative framework. Because regulation is arguably the most important factor that an analyst must consider in assessing the investment attractiveness of a utility, a ranking such as RRA's serves to put all state commissions on a level playing field for investors. It should be noted that these rankings are not static, as demonstrated by both RRA's and Barclays' changed evaluations of PUCO over the past year. The Commission's decision in the current proceedings will clearly be taken into account by equity investors.

Q. TURN NOW TO THE CURRENT PROCEEDINGS. PLEASE DISCUSS THE COMPANY'S REQUEST.

A. As a Fixed Resource Requirement (FRR) provider of capacity, Duke Energy Ohio is seeking a cost-based charge for that service. The Company further is asking the PUCO permission to defer, for subsequent collection, the difference between that cost-based charge and the market-based price it is now receiving from PJM.

Q. WHY HAS THE COMPANY MADE THIS REQUEST?

A. It is my understanding that, subsequent to the PUCO's approving Duke Energy Ohio's ESP request in November 2011, the Commission issued an order for Ohio Power, Inc. (AEP Ohio), on July 2, 2012. In that ruling, AEP Ohio was granted a state compensation mechanism for pricing its FRR capacity service at its cost. Because the Company is also an FRR provider and is in an analogous position from several standpoints, it seeks application of the same mechanism. Such pricing would represent fair and balanced treatment, as well as a recognition of economic realities that are discussed by other Duke

Energy Ohio witnesses.

Q. IS DUKE ENERGY OHIO SEEKING THE EXACT AMOUNTS THAT AEP OHIO WAS GRANTED?

A. No. The Company's application is specific to its own financial circumstances.

Q. WHAT RELEVANCE DOES THE PUCO'S DECISION IN THESE PROCEEDINGS HAVE FOR INVESTORS?

A. As Duke Energy Ohio's filing clearly states, the pricing that the Company currently receives, from PJM, for its FRR capacity obligations reflects amounts that are significantly below its cost to provide that capacity. This circumstance is not expected to change over the next three years; rather, the Company projects that returns on shareholders' investment during that period range from a loss of 3.6 percent to an even more significant loss of 13.5 percent. Investors are aware of this subpar return and understand that it is not sustainable. As discussed previously, the financial outlook of Duke Energy Ohio will have a bearing on the financial expectations for Duke Energy, in which equity investors can take a stake.

These proceedings have represented an uncertainty in the outlook for the Company and its parent, and, accordingly, an overhang for Duke Energy's stock price. Granted, there are other factors that investors evaluate in their consideration of the parent's stock, but the impact of these proceedings cannot be minimized.

Q. WHAT CONCLUSIONS MIGHT INVESTORS DRAW IF THE COMMISSION GRANTED DUKE ENERGY OHIO ITS REQUEST FOR A COST-BASED CHARGE BASED UPON A STATE COMPENSATION MECHANISM FOR CAPACITY?

A. I believe investors would view the PUCO's authorization of a state-based compensation mechanism for the Company's capacity to be a decision that reflects a balanced, constructive regulatory environment. Such a ruling would be consistent with the pricing method permitted for another, similarly situated FRR entity in Ohio. It also would permit Duke Energy Ohio the opportunity to earn a fair and reasonable return on its investment in the state, which would translate into a fair and reasonable return on investors' investment. In sum, I think investors would endorse such a ruling.

Q. HOW MIGHT INVESTORS REGARD A DENIAL OF THE COMPANY'S REQUEST?

A. I believe that investors would consider a ruling by the PUCO against the Company's petition to be inconsistent and unbalanced. They would recognize that Duke Energy Ohio is not receiving fair capacity pricing compensation relative to another FRR. That, in turn, means that the portion of their investment in Duke Energy common stock represented by Duke Energy Ohio is not receiving a reasonable return, and that economic realities have not been taken into consideration in the PUCO's decision. Consequently, those investors would also be on the alert to a possible change in the ownership of a portion of Ohio's generating capacity. In sum, a denial of Duke Energy Ohio's request could lead investors' overall perceptions of the Ohio regulatory environment to decline.

III. <u>CONCLUSION</u>

Q. PLEASE SUMMARIZE THE VIEWPOINT OF INVESTORS IN RESPECT TO THE CURRENT PROCEEDING.

A. Equity investors place considerable emphasis on regulation in assessing the investment merits of a utility common stock. This is because regulators play a significant role in determining the earnings, cash flows, and, accordingly, the financial intergrity of a utility. These factors in turn are the underpinning of an investment valuation. Consequently, investors place a high value on regulation that is consistent, constructive, fair, reasonable, and attuned to economic realities.

Although only the Company's parent is able to issue common stock, the prospects of all of Duke Energy's subsidiaries, including Duke Energy Ohio, are taken into account in investors' analysis. At the present time, these proceedings have significant bearing on the Company's outlook. Investors understand that the Company's current receipt, from PJM, of market pricing for capacity will lead to decidedly subpar returns over the next three years, with projections of losses during that period ranging from 3.6 percent to 13.5 percent. Such returns, resulting from pricing that does not reflect the PUCO's recently established cost-based, state compensation mechanism for capacity, are unacceptable by any standards.

Should the Company's request in the instant proceedings for adoption of a fair pricing mechanism be permitted by the Commission, investors would, in my estimation, applaud it as reflective of fair, consistent, and constructive regulation. A denial of the request, which would be inconsistent with pricing treatment for another, similarly situated FRR entity in the state and would result in a continuation of negative returns for Duke Energy Ohio, would not be warmly embraced.

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

A. Yes.

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Summary of Testimony Experience
Julie M. Cannell

JURISDICTION	CASE OR DOCKET NO.	CLIENT	DATE FILED
Arkansas	13-028-U	Entergy Arkansas, Inc. (Entergy Corp.)	2013
Louisiana	U-32708	Entergy Louisiana, LLC (Entergy Corp.)	2013
Louisiana	U-32707	Entergy Gulf States Louisiana, L.L.C. (Entergy Corp.)	2013
Pennsylvania	R-2012-2290597	PPL Electric Utilities (PPL Corp.)	2012
U.S. District Court for the Northern District of Alabama, Southern Division	2:01-cv-00152-VEH	Alabama Power Company	2012
Kentucky	2011-00042	Kentucky Power Company and AEP Kentucky Transmission Company Inc. (American Electric Power)	2012
Maryland	C-9286	Delmarva P&L (Pepco Holdings)	2011
Maryland	C-9285	Potomac Electric Power Co. (Pepco Holdings)	2011
Delaware	D-11-528	Delmarva P&L (Pepco Holdings)	2011
Oklahoma	2011-87	Oklahoma Gas & Electric (OGE Energy)	2011
New Jersey	D-ER-11080469	Atlantic City Electric (Pepco Holdings)	2011

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JURISDICTION	CASE OR DOCKET NO.	CLIENT	DATE
District of Columbia	FC1087	Potomac Electric Power (Pepco Holdings)	2011
Maryland	9249	Delmarva P&L (Pepco Holdings, Inc.)	2010
Vermont	7627	Central Vermont Public Service Corporation	2010
Texas	38480	Texas-New Mexico Power (PNM Resources)	2010
Minnesota	E-015/GR-09-1151	Minnesota P&L (Allete, Inc.)	2010
Pennsylvania	R-2010-2161694	PPL Electric Utilities (PPL Corp.)	2010
Wisconsin	3270-UR-117	Madison G&E (MGE Energy)	2010
South Carolina	D-2009-489-E	South Carolina E&G (SCANA Corp.)	2010
Missouri	ER-2010-0036	Ameren UE (Ameren)	2010
Rhode Island	4065	Narragansett Electric (National Grid)	2009
Colorado	09AL-299E	Public Service Company of Colorado (Xcel Energy)	2009
Massachusetts	DPU 09-39	Massachusetts Electric (National Grid)	2009
Wisconsin	3270-UR-116	Madison G&E (MGE Energy)	2009
Maryland	N/A	Baltimore G&E (Constellation Energy)	2008
New York	08-E-0539	Consolidated Edison Company of New York (Consolidated Edison, Inc.)	2008
South Carolina	2007-229-E	South Carolina E&G (SCANA Corp.)	2007

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Jurisdiction	Case or Docket No.	Client	Date
Pennsylvania	R-00072155	PPL Electric Utilities (PPL Corp.)	2007
Oklahoma	PUD 200600285	Public Service Co. of Oklahoma (American Electric Power)	2007
Virginia	PUE-2006-00065	Appalachian Power Co. (American Electric Power)	2006
Arizona	E-01345A-05-0816	Arizona Utility Investors Association [Arizona Public Service docket]	2006
Texas	32093	CenterPoint Energy	2006
Texas	32008	CenterPoint Energy	2006
Pennsylvania	R-00061346	Duquesne Light	2006
Washington	UE-060181	Avista Corporation	2006
Oklahoma	PUD 200500151	Oklahoma G&E (OGE Energy)	2005
Pennsylvania	R-00049255	PPL Electric Utilities (PPL Corp.)	2004
Oklahoma	N/A	Oklahoma G&E (OGE Energy)	2004
South Carolina	2004-178-E	South Carolina E&G (SCANA Corp.)	2004
Nevada	04-6030	Nevada Power (Sierra Pacific Resources)	2004
Connecticut	01-10-10	United Illuminating (UIL Holdings)	2001
Missouri	ER 99-247; ER-99-573	St. Joseph Light & Power	1999
Kansas Missouri	97-WSRE-676-MER EM-97-515	Western Resources	1997
Virginia	PUE960296	Virginia Power (Dominion Resources)	1997