

EXHIBIT NO. \_\_\_\_\_

BEFORE  
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of	)	
Ohio Power Company for an	)	Case No. 20-585-EL-AIR
Increase in Electric Distribution Rates.	)	
 In the Matter of the Application of	 )	
Ohio Power Company	)	Case No. 20-586-EL-ATA
for Tariff Approval.	)	
 In the Matter of the Application of	 )	
Ohio Power Company for Approval	)	Case No. 20-587-EL-AAM
to Change Accounting Methods.	)	

DIRECT TESTIMONY OF  
FRANZ D. MESSNER  
ON BEHALF OF  
OHIO POWER COMPANY

Management Policies, Practices & Organizations

Operating Income

Rate Base

Allocations

X Rate of Return

Rates and Tariffs

Other

Filed: June 15<sup>th</sup>, 2020

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FRANZ D. MESSNER

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BEFORE  
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DIRECT TESTIMONY OF  
FRANZ D. MESSNER  
ON BEHALF OF  
OHIO POWER COMPANY

1   **I.    PERSONAL DATA**

2   **Q.    PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

3   A.    My name is Franz D. Messner, and my business address is 1 Riverside Plaza, Columbus,  
4       Ohio, 43215.

5   **Q.    BY WHOM ARE YOU EMPLOYED AND WHAT IS YOUR POSITION?**

6   A.    I am employed by American Electric Power Service Corporation (“AEPSC”) as Managing  
7       Director of Corporate Finance. AEPSC supplies engineering, financing, accounting,  
8       planning, advisory, and other services to the subsidiaries of the American Electric Power  
9       (“AEP”) system, one of which is Ohio Power Company (“AEP Ohio” or the “Company”).

10  **Q.    PLEASE DESCRIBE YOUR EDUCATIONAL AND PROFESSIONAL**  
11  **BACKGROUND?**

12  A.    I earned a Bachelor of Science in Systems Engineering from the United States Naval  
13       Academy in 1990. I earned a Master of Business Administration from the Fisher College  
14       of Business at the Ohio State University in 1999. Prior to joining AEP, I served for  
15       approximately seven years as a U.S. Naval officer and completed both chief engineer and  
16       submarine officer qualifications.

17           In June 1999, I was hired by AEPSC as an associate in a finance associate  
18       development program. My primary roles have been in the areas of financial analysis,  
19       budgeting, and forecasting. In July 2007, I was named Manager in Corporate Planning and

1 Budgeting and subsequently promoted to Director in November 2009. In May 2016, I  
2 assumed my current position as Managing Director of Corporate Finance.

3 **Q. WHAT ARE YOUR RESPONSIBILITIES AS MANAGING DIRECTOR OF**  
4 **CORPORATE FINANCE?**

5 A. I am responsible for planning and executing the corporate finance programs of the  
6 regulated AEP System operating companies, including AEP Ohio. My responsibilities also  
7 include preparing recommendations for the payment of dividends by those companies,  
8 maintaining capitalization targets, and managing the relationships of AEP and its  
9 subsidiaries with the credit rating agencies.

10 **Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY IN ANY REGULATORY**  
11 **PROCEEDINGS?**

12 A. Yes. I submitted testimony before the Indiana Utility Regulatory Commission in Causes  
13 No. 44967 and No. 45235 and before the Michigan Public Service Commission in Cause  
14 No. U-18370 on behalf of Indiana Michigan Power Company ("I&M"). I submitted  
15 testimony and testified on I&M's behalf before the Michigan Public Service Commission  
16 in Cause No. U-20359. I also submitted testimony to the Public Utilities Commission of  
17 Ohio ("Commission") on AEP Ohio's behalf in the Company's 2018 and 2019  
18 Significantly Excessive Earnings Test proceedings. Additionally, I have prepared or had  
19 prepared under my direct supervision financing applications submitted on behalf of AEP  
20 Ohio to the Commission.

1    **II.    PURPOSE OF TESTIMONY**

2    **Q.    WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

3    A.    The purpose of my testimony in this proceeding is to present and support AEP Ohio's  
4           capital structure and weighted average cost of capital. I also describe AEP Ohio's credit  
5           ratings and why regulatory outcomes are important in the rating process.

6    **Q.    ARE YOU SPONSORING ANY SCHEDULES IN THIS PROCEEDING?**

7    A.    Yes, I am sponsoring all or portions of the following Schedules for AEP Ohio and AEP:

- 8           •    Schedule D-1 Rate of Return Summary
- 9           •    Schedule D-1.1 Common Equity
- 10          •    Schedule D-2 Cost of Short-term Debt
- 11          •    Schedule D-3 Cost of Long-term Debt
- 12          •    Schedule D-4 Cost of Preferred Stock
- 13          •    Schedule D-5 Comparative Financial Data

14   **III.   WEIGHTED AVERAGE COST OF CAPITAL**

15   **Q.    PLEASE DESCRIBE THE DATA YOU USED IN PREPARING SCHEDULES D-1**  
16   **THROUGH D-5.**

17   A.    Pursuant to the instructions contained in the Commission's Standard Filing Requirements,  
18           Schedules D-1 through D-4 were prepared with data using a December 31, 2019 date  
19           certain. Schedule D-5 was prepared using the Company's test year December 1, 2019  
20           through November 30, 2020, as well as historical information from the ten most recent  
21           fiscal years.

**Q. PLEASE DESCRIBE SCHEDULE D-1A, RATE OF RETURN SUMMARY AS OF DECEMBER 31, 2019 FOR AEP OHIO.**

A. Schedule D-1A (also shown in Figure FDM-1) depicts the calculation of the weighted average cost of capital proposed in this case for AEP Ohio. AEP Ohio's weighted average cost of capital as of December 31, 2019, is 7.90%. Schedule D-3A supports the embedded cost of long-term debt on Line 1 of Schedule D-1A. Schedule D-4A supports the embedded cost of preferred stock on Line 2 of Schedule D-1A. Schedule D-1.1B supports the amount of common equity on Line 3 of Schedule D-1A. Company witness McKenzie supports the common equity cost rate of 10.15%. Amounts on line 5, accumulated deferred investment tax credit; line 6, accumulated deferred income taxes (accelerated amortization); and line 7, accumulated deferred income taxes (other property) in Schedule D-1A were provided to me by Company witness Multer.

**Figure FDM-1  
Weighted Average Cost of Capital  
12/31/2019  
(Schedule D-1A)**

Line No.	Class of Capital	Reference	(\$) Amount	% of Total	(%) Cost	Weighted Cost (%)
1	Long-Term Debt	D-3A	2,100,000,000	45.57%	5.22% <sup>(1)</sup>	2.38%
2	Preferred Stock	D-4A	-	0.00%	0.00%	0.00%
3	Common Equity		<u>2,508,479,717</u>	<u>54.43%</u>	<u>10.15%</u>	<u>5.52%</u>
4	Total Capital		<u>4,608,479,717</u>	<u>100%</u>		<u>7.90% <sup>(1)</sup></u>
5	Accumulated Deferred Investment Tax Credit			<u>1,495</u>		
6	Accumulated Deferred Income Taxes (Accelerated Amortization)			<u>908,281,337</u>		
7	Accumulated Deferred Income Taxes (Other Property)			<u>42,650,705</u>		

(1) The 7.90% weighted average cost of capital included in the pre-filing notice was based, in part, on an embedded cost of long-term debt of 5.22%. Subsequent to that filing an adjustment to the application of "Premium/(Discount) at Issuance" and "Issuance Expenses" in the embedded cost of long-term debt was identified. After that adjustment, the embedded cost of long-term debt is 5.26%, resulting in an adjusted weighted average cost of capital of 7.92%.

1 **Q. PLEASE DESCRIBE SCHEDULE D-2A, COST OF SHORT-TERM DEBT AS OF**  
2 **DECEMBER 31, 2019 FOR AEP OHIO.**

3 A. Schedule D-2A identifies the amount and cost of short-term debt outstanding as of  
4 December 31, 2019 at AEP Ohio. As of December 31, 2019, AEP Ohio had \$131 million  
5 of short-term debt outstanding.

6 **Q. PLEASE DESCRIBE SCHEDULE D-3A, COST OF LONG-TERM DEBT AS OF**  
7 **DECEMBER 31, 2019 FOR AEP OHIO.**

8 A. Schedule D-3A identifies all long-term debt outstanding as of December 31, 2019 at AEP  
9 Ohio, including related issuances expenses. Issuance expenses include premiums and  
10 discounts, issuance expenses, and costs of reacquired debt. The embedded cost of AEP  
11 Ohio long-term debt as of December 31, 2019 is 5.26%.

12 **Q. PLEASE DESCRIBE THE CALCULATION OF THE EMBEDDED COST OF**  
13 **LONG-TERM DEBT.**

14 A. Schedule D-3A contains the calculation of the embedded cost of long-term debt as of  
15 December 31, 2019. It includes details of each series of debt, the date of issuance, maturity  
16 date, original amount issued, and associated issuance costs. The premium/discount and  
17 issuance expense columns represent legal, underwriting, and other miscellaneous costs  
18 associated with the issuance. The annualized cost is calculated by taking the effective cost  
19 rate, which includes all costs associated with the debt, and multiplying it by the principal  
20 outstanding.

21 **Q. PLEASE DESCRIBE SCHEDULE D-4A, COST OF PREFERRED STOCK AS OF**  
22 **DECEMBER 31, 2019 FOR AEP OHIO.**

23 A. AEP Ohio had no preferred stock outstanding as of December 31, 2019.

1 **Q. PLEASE DESCRIBE SCHEDULE D-5A, COMPARATIVE FINANCIAL DATA**  
2 **FOR AEP OHIO.**

3 A. Schedule D-5A presents certain test year and historical financial information using the  
4 Company's test year December 2, 2019 through November 30, 2020, as well as historical  
5 information from the ten most recent fiscal years.

6 I sponsor the following data elements contained in these schedules:

- 7 • Capital Structure on lines 14 – 17
- 8 • Costs of Capital on lines 36 – 38
- 9 • Stock and Bond Ratings on lines 46 – 50
- 10 • Common Stock Related Data on lines 52 – 64

11 **Q. PLEASE DISCUSS FOOTNOTE 1 IN FIGURE FDM 1 AND SCHEDULES D-1A**  
12 **AND D-3A.**

13 A. During final preparation of Schedule D-3A, Embedded Cost of Long-Term Debt, an  
14 adjustment to the application of "Premium/(Discount) at Issuance" and "Issuance Expense"  
15 in the calculation of the "Effective Cost Rate" was identified. Specifically, these costs  
16 were added to the "Principal Amount Issued", which lowered the result of the calculation  
17 of overall Embedded Cost of Long-Term Debt used in the calculation of the weighted  
18 average cost of capital in Schedule D1A. After that adjustment, the Embedded Cost of  
19 Long-Term Debt increases to 5.26%, resulting in an adjusted weighted average cost of  
20 capital of 7.92%.



1    **IV.    CREDIT RATING**

2    **Q.    WHAT ARE CREDIT RATINGS AND WHAT IS AN INVESTMENT GRADE**  
3    **RATING?**

4    A.    Credit ratings are opinions on a company's ability to repay its debt and other obligations  
5    in full and on time. Credit ratings facilitate the process of issuing bonds by providing a  
6    widely recognized measure of relative credit risk. Investors may also use ratings as a  
7    screening device for investments. For example, an investor may choose only to invest in  
8    investment grade corporations or utilities.

9    **Q.    GENERALLY DESCRIBE THE METHODOLOGY OF EACH RATING**  
10   **AGENCY.**

11   A.    S&P evaluates the credit of each operating company utilizing a family approach, factoring  
12   in the ratings of all AEP system subsidiaries. S&P's family approach to bond ratings for  
13   individual operating companies stresses the inherent benefits and risks associated with  
14   having a diversified family of operating companies across AEP's eleven-state service  
15   territory.

16            Moody's rates each operating company individually based on the merits of the  
17   company's operations and credit profile but does recognize that each is part of a larger  
18   holding company.

19   **Q.    PLEASE PROVIDE A SUMMARY OF THE CURRENT SENIOR UNSECURED**  
20   **CREDIT RATINGS FOR AEP OHIO.**

21   A.    AEP Ohio is rated A- by Standard and Poor's (S&P) and A2 by Moody's Investor Service  
22   (Moody's). On April 7, 2020, S&P published a credit opinion on AEP Ohio reaffirming  
23   the rating of A- (stable). On March 6, 2020, Moody's revised its outlook on AEP Ohio

1 from stable to negative. On March 11, 2020, Moody's published a credit opinion on AEP  
2 Ohio reaffirming its rating of A2 (negative). Although Moody's generally recognizes AEP  
3 Ohio's low business risk profile as a regulated transmission and distribution utility  
4 operating under a credit supportive regulatory jurisdiction, the change in Moody's credit  
5 rating outlook is based on Moody's view that AEP Ohio's financial profile is weakening  
6 and that there is a potential for the rating to move downward if the outcome of this case is  
7 not credit supportive.

8 **Q. IS REGULATORY TREATMENT IMPORTANT TO THE RATING AGENCIES?**

9 A. A significant portion of the Company's credit rating is based on qualitative factors related  
10 to the regulatory environment. Rating agencies closely follow regulatory outcomes for a  
11 utility. Consistent and appropriate regulatory treatment is credit positive and supports the  
12 Company's credit ratings, which in turn affords the Company better access to capital  
13 markets to source capital at lower cost. This is important in times of increased debt capital  
14 market uncertainty as experienced in the first quarter of 2020.

15 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

16 A. Yes.

## **CERTIFICATE OF SERVICE**

In accordance with Rule 4901-1-05, Ohio Administrative Code, the PUCO's e-filing system will electronically serve notice of the filing of this document upon the following parties. In addition, I hereby certify that a service copy of the foregoing *Direct Testimony of Franz D. Messner* was sent by, or on behalf of, the undersigned counsel to the following parties of record this 15<sup>th</sup> day of June 2020, via electronic transmission.

/s/ *Steven T. Nourse* \_\_\_\_\_

Steven T. Nourse

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Summary: Testimony - Direct Testimony of Franz D. Messner on Behalf of Ohio Power Company electronically filed by Mr. Steven T Nourse on behalf of Ohio Power Company