

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of)	
Duke Energy Ohio, Inc., for an)	Case No. 21-887-EL-AIR
Increase in Electric Distribution Rates.)	
In the Matter of the Application of)	
Duke Energy Ohio, Inc., for Tariff)	Case No. 21-888-EL-ATA
Approval.)	
In the Matter of the Application of)	
Duke Energy Ohio, Inc., for Approval)	Case No. 21-889-EL-AAM
to Change Accounting Methods.)	

DIRECT TESTIMONY OF

CHRISTOPHER R. BAUER

ON BEHALF OF

DUKE ENERGY OHIO, INC.

_____	Management policies, practices, and organization
_____	Operating income
_____	Rate base
_____	Allocations
_____	Rate of return
_____	Rates and tariffs
<u> X </u>	Other: Capital Structure

October 15, 2021

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I. INTRODUCTION AND PURPOSE

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

2 A. My name is Christopher R. Bauer and my business address is currently 550 South
3 Tryon Street, Charlotte, North Carolina 28202. Effective November 1, 2021, that
4 address will change to 526 South Church Street, Charlotte, North Carolina 28202.

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

6 A. I am employed by Duke Energy Business Services LLC (DEBS) as Director,
7 Corporate Finance and Assistant Treasurer. I am also the Assistant Treasurer of
8 Duke Energy Ohio, Inc. (Duke Energy Ohio or the Company). DEBS provides
9 various administrative and other services to Duke Energy Ohio and other
10 affiliated companies of Duke Energy Corporation (Duke Energy).

11 **Q. PLEASE BRIEFLY SUMMARIZE YOUR EDUCATION AND**
12 **PROFESSIONAL EXPERIENCE.**

13 A. I received a Bachelor of Arts degree from Flagler College in 2003 and an MBA
14 degree from the University of North Florida in 2004. I am a licensed Certified
15 Public Accountant in the state of Florida. From 2004 to 2010, I worked in
16 Deloitte's Audit and Enterprise Risk Services unit, providing financial statement
17 and internal control services across various industries. In 2010, I joined Duke
18 Energy as a Lead Audit Consultant in the Internal Audit Department. In 2015, I
19 moved to Duke Energy's Investor Relations group where I served as a Manager
20 responsible for communicating the company's strategic, operating and financing
21 plan to debt and equity investors and external stakeholders. In 2017, I moved to
22 the Treasury department and served as both a Treasury Director and the Director

1 of Credit & Capital Markets before assuming my current role in early 2021.

2 **Q. PLEASE SUMMARIZE YOUR RESPONSIBILITIES AS DIRECTOR,**
3 **CORPORATE FINANCE AND ASSISTANT TREASURER.**

4 A. I am responsible for financing the operations of Duke Energy and its subsidiary
5 utilities. This includes the issuance of new debt and equity securities, as well as
6 obtaining other sources of external funds. My responsibilities also include
7 financial risk management for Duke Energy and its subsidiaries. Additionally, I
8 maintain relationships with Duke Energy's commercial banks, the fixed income
9 investor community, and the credit rating agencies.

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

12 A. No.

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

15 A. My testimony will address Duke Energy Ohio's financial objectives, credit
16 quality, capital structure, and cost of capital. Throughout my testimony, I will
17 emphasize the importance of Duke Energy Ohio's continued ability to meet its
18 financial objectives and maintain strong credit quality. In that regard, I sponsor
19 Rate of Return Schedules D-1A (Duke Energy Ohio Consolidated) and D-1B
20 (Duke Energy Consolidated), Common Equity Schedule D-1.1, Embedded Cost
21 of Long-Term Debt Schedules D-3A (Duke Energy Ohio Consolidated) and D-3B
22 (Duke Energy Consolidated), Embedded Cost of Preferred Stock Schedules D-4A
23 (Duke Energy Ohio Consolidated) and D-4B (Duke Energy Consolidated) and

1 page 3 of Comparative Financial Data Schedules D-5A (Duke Energy Ohio
2 Consolidated) and D-5B (Duke Energy Consolidated). I also sponsor
3 Supplemental Filing Requirement (C)(2), prospectus of current stock and/or bond
4 offerings.

II. DUKE ENERGY OHIO'S FINANCIAL OBJECTIVES

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

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

18 Q. WHAT RATEMAKING TREATMENT IS BEING REQUESTED IN 19 THESE PROCEEDINGS AND HOW WILL THE COMPANY'S 20 FINANCIAL OBJECTIVES BE IMPACTED?

21 A. As explained by Duke Energy Ohio witness Amy B. Spiller, Duke Energy Ohio
22 proposes to increase our electric distribution base rates to increase our annual

1 electric base revenues for our electric business by approximately \$55 million,
2 which results in an approximate 3.3 percent average increase to the customer's
3 total bill. As part of this request, supported by the analysis and testimony of Duke
4 Energy Ohio witness Dylan D'Ascendis, the Company is requesting an allowed
5 Return on Equity (ROE) of 10.3 percent. The proposed capitalization in this
6 request comprises 49.5 percent long-term debt and 50.5 percent equity. Approval
7 of the Company's request in this case will support its financial objectives by
8 ensuring timely cash recovery of its prudently incurred costs.

III. CREDIT QUALITY & CREDIT RATINGS

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

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

16 Many qualitative and quantitative factors go into this assessment. Qualitative
17 aspects may include Duke Energy Ohio's regulatory climate, its track record for
18 delivering on its commitments, the strength of its management team, its corporate
19 governance, its operating performance, and its service territory. Quantitative
20 measures are primarily based on operating cash flow and focus on Duke Energy
21 Ohio's ability to meet its fixed obligations (interest expense, in particular) on the
22 basis of internally generated cash and the level at which Duke Energy Ohio

1 maintains debt balances. The percentage of debt to total capital is another example
2 of a quantitative measure. Creditors and credit rating agencies view both qualitative
3 and quantitative factors in the aggregate when assessing the credit quality of a
4 company.

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

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

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

1 A. As of the date of this testimony, S&P and Moody's rated Duke Energy Ohio's
2 outstanding debt as follows:

Rating Agency	S&P	Moody's
Senior Secured	A	A2
Senior Unsecured	BBB+	Baa1
Outlook	Stable	Stable

3 As seen in Schedule D-3A, Duke Energy Ohio currently issues secured First
4 Mortgage Bonds, which are rated higher than the senior unsecured debt Duke
5 Energy Ohio issued prior to the Duke Energy/Cinergy merger. There are four key
6 factors that drive the credit ratings of the electric and gas utility sector: regulatory
7 framework, ability to recover costs and earn returns, diversification, and financial
8 strength. Obligations carrying a credit rating in the "A" category are considered
9 strong, investment-grade securities subject to low credit risk for the investor. "A"
10 rated debt is presumed to be somewhat susceptible to changes in circumstances
11 and economic conditions; however, the debt issuer's capacity to meet its financial
12 commitments is considered strong. By contrast, ratings in the "BBB" category are
13 considered adequate and have less assurance of access to the capital markets in
14 challenging market conditions.

15 S&P may also modify its ratings with the use of a plus or minus sign to
16 further indicate the relative standing within a major rating category. An "A+"
17 credit rating is at the higher end of the "A" credit rating category and an "A-" is at
18 the lower end of the category. Moody's credit rating assignments use the numbers
19 "1", "2" and "3", with the numbers "1" and "3" analogous to a "+" and "-",
20 respectively. For example, Moody's credit ratings of "A2" and "A3" would be

1 analogous to “A” and “A-” credit ratings at S&P, respectively.

2 The ratings outlook assesses the potential direction of a long-term credit
3 rating over an intermediate term (typically six months to two years). Duke Energy
4 Ohio’s “Stable” outlook at S&P and Moody’s is an indication the credit ratings
5 are not likely to change at this time, however a change in outlook or rating could
6 occur if the Company experiences a change in its business or financial risk.

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

9 A. To assure reliable and cost-effective service, and to fulfill its obligations to serve
10 customers, the Company must continuously plan and execute major capital projects.
11 This is the nature of regulated, capital-intensive industries like electric and gas
12 utilities. The Company must be able to operate and maintain its business without
13 interruption and refinance maturing debt on time, regardless of financial market
14 conditions. The financial markets continue to experience periods of volatility, most
15 recently driven by the Covid-19 pandemic and the uncertainty surrounding fiscal,
16 monetary, and foreign policy under a new administration. Duke Energy Ohio must
17 be able to finance its needs throughout such periods and strong investment-grade
18 credit ratings provide the Company greater assurance of continued access to the
19 capital markets on reasonable terms during periods of volatility.

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

22 A. With respect to the regulated transmission and distribution businesses of Duke
23 Energy Ohio, the rating agencies believe the Ohio regulatory environment generally

1 supports long-term credit quality with timely and sufficient recovery of prudently
2 incurred costs and expenses. S&P has maintained Duke Energy Ohio's business risk
3 profile of "Excellent" since the Company's sale of its merchant generation assets in
4 2015. Generally speaking, the credit rating agencies have identified the following
5 Strengths and Challenges when assessing the credit quality of Duke Energy Ohio:

6 • Credit Strengths:

- 7 ○ Entirely regulated transmission and distribution business; and
- 8 ○ Supportive regulatory framework that includes riders for cost
9 recovery.

10 • Credit Challenges:

- 11 ○ Sizeable capital program,
- 12 ○ Delay in recovery of manufactured gas plant remediation spending;
13 and
- 14 ○ Ownership of a higher risk, vertically integrated Kentucky utility.

15 The rating agencies speak to the importance of a constructive regulatory
16 framework and the outcomes of future rate cases as areas of focus. Such
17 comments highlight the importance of the outcome of these proceedings in
18 supporting credit quality and the Company's financial objectives. The agencies
19 also highlight Duke Energy Ohio's potential risk in the ownership of Duke
20 Energy Kentucky. Duke Energy Kentucky issues senior unsecured debt, which
21 S&P downgraded for Duke Energy Corp. and its subsidiaries from "A-" to
22 "BBB+" on January 26, 2021. S&P utilizes a family rating methodology, whereby
23 the credit rating and outlook of the parent company, Duke Energy, is applied to

1 each of the parent's subsidiaries. In its January 2021 Duke Energy report,¹ S&P
2 attributed the downgrade to weaker consolidated financial metrics primarily as a
3 result of the coal ash settlement reached at Duke Energy Carolinas and Duke
4 Energy Progress and Duke Energy's elevated capital expenditure plan. S&P's
5 outlook of "stable" is predicated on the expectation that Duke Energy and its
6 subsidiaries will be able to manage regulatory risk while capital spending remains
7 high. Moody's affirmed Duke Energy and its subsidiaries' senior unsecured Baa1
8 rating and stable outlook in January 2021.

IV. CAPITAL STRUCTURE AND COST OF CAPITAL

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

10 A. As mentioned earlier in my testimony, Duke Energy Ohio Consolidated's proposed
11 capital structure comprises 49.5 percent long-term debt and 50.5 percent equity, after
12 making adjustments for purchase accounting and other items. The Company
13 believes this proposed capital structure is appropriate for Duke Energy Ohio, as it
14 introduces an appropriate amount of risk due to leverage and minimizes the
15 weighted average cost of capital to customers. Approval of the proposed capital
16 structure will help Duke Energy Ohio maintain its credit quality to meet its ongoing
17 business objectives. This level is also consistent with the Company's target credit
18 ratings.

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

20 A. Mr. D'Ascendis testifies that the Company's cost of equity is in the range of 10.06

¹ S&P Global Ratings, Research Update, "Duke Energy Corp. And Subsidiaries Downgraded To 'BBB+' On Coal Ash Settlement, Outlook Stable," January 26, 2021 ("January 2021 Duke Energy Corporation Report").

1 percent to 12.06 percent. The Company supports Mr. D'Ascendis's analysis and is
2 requesting 10.3 percent as the Company's allowed ROE.

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

6 A. Equity investors provide the foundation of a company's capitalization by
7 providing significant amounts of capital, for which an appropriate economic
8 return is required. Duke Energy Ohio compensates equity investors for the risk of
9 their investment by targeting fair and adequate returns, a stable dividend policy,
10 and earnings growth. These are necessary to preserve ongoing access to equity
11 capital. Returns to equity investors are realized only after all operating expenses
12 and fixed payment obligations (including debt principal and interest) of the
13 Company have been paid. Because equity investors are the last in priority to a
14 company's assets, their investment is at the most risk should the company suffer
15 any underperformance. For this reason, equity investors require a higher return on
16 investment. Equity investors expect utilities like Duke Energy Ohio to recover
17 their prudently incurred costs and earn a fair and reasonable return for their
18 investors. The Company's proposal in these proceedings supports this investor
19 requirement.

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

22 A. Capital structure and return on equity are important components of credit quality.

1 Equity capital is subordinate to debt capital, thereby providing cushion and safer
2 returns for debt investors. Accordingly, equity capital is a more expensive form of
3 capital. The Company seeks to maintain a level of equity in the capital structure
4 that ensures high credit quality, while minimizing its overall cost of capital. An
5 adequate ROE will allow the Company to generate earnings and cash flows to
6 properly compensate equity investors for their capital at risk while protecting debt
7 investors with a higher degree of credit quality. High credit quality improves
8 financial flexibility by providing more readily available access to the capital
9 markets on reasonable terms, and ultimately lower debt financing costs.

10 **Q. DO YOU BELIEVE THAT DUKE ENERGY OHIO'S CAPITAL**
11 **STRUCTURE IN THIS CASE HAS AN ADEQUATE EQUITY**
12 **COMPONENT TO ENABLE THE COMPANY TO ACHIEVE ITS**
13 **FINANCIAL STRENGTH AND CREDIT QUALITY OBJECTIVES?**

14 A. Yes. Duke Energy Ohio's equity component, as supported in these proceedings,
15 enables it to maintain current credit ratings and financial strength and flexibility.
16 This level of equity enables the Company to operate through different business
17 cycles while also providing cushion to the Company's lenders and bondholders. The
18 Company's current and future capital expenditures require the need for a strong
19 equity component of the Company's capital structure in order to maintain access to
20 capital funding at reasonable terms.

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

23 A. Duke Energy Ohio's weighted-average cost of long-term debt as of June 30, 2021, is

1 4.16 percent. This long-term debt cost reflects an adjustment to eliminate the
2 influence of the interest rate associated with pollution control bonds issued by a
3 subsidiary of the Company. The adjustment assumes the interest rate for pollution
4 control bonds is equal to the weighted cost of all other long-term debt (4.16%). As
5 the pollution control bonds are directly related to generation assets, the special
6 interest rate for these bonds has been ignored. While the interest rate for these bonds
7 has been adjusted, the total debt in the capital structure has not been changed. The
8 adjustment to remove the impact of pollution control bonds is the same adjustment
9 made in all of the Company's prior rate cases that were filed after its generating
10 business was deregulated.

V. FUNDING OF DUKE ENERGY OHIO'S FORECASTED CAPITAL REQUIREMENTS

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

13 A. Duke Energy Ohio's capital requirements are expected to be funded from internal
14 cash generation, the issuance of debt, and equity funding from Duke Energy
15 Corporation. It is important to note that Duke Energy makes quarterly dividend
16 payments to its equity shareholders. Accordingly, Duke Energy Corporation's
17 operating subsidiaries are expected to distribute approximately 70 percent of their
18 earnings, over the long run, to support Duke Energy Corp's dividend payments.

VI. SCHEDULES, FILING REQUIREMENTS AND INFORMATION SPONSORED BY WITNESS

19 **Q. PLEASE DESCRIBE SUPPLEMENTAL FILING REQUIREMENT (C)(2).**

20 A. Supplemental Filing Requirement (C)(2) is a copy of the prospectus from the most

1 recent Duke Energy Corporation common and preferred stock offerings and Duke
2 Energy Ohio and Duke Energy bond offerings.

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

4 A. Schedule D-1A is a summary showing the calculation of the rate of return on rate
5 base being proposed in this case for Duke Energy Ohio. Schedule D-1B is a similar
6 summary of the rate of return using Duke Energy's capital structure. The
7 accumulated deferred income tax and accumulated deferred investment tax credit
8 balances were derived from Schedule B-6, supported by Duke Energy Ohio witness
9 John R. Panizza. The adjustments to the capital structure were provided by Duke
10 Energy Ohio witness Danielle L. Weatherston. I sponsor the information being used
11 for the calculation of the debt component and Mr. D'Ascendis provided the rate of
12 ROE.

13 **Q. PLEASE DESCRIBE SCHEDULE D-1.1.**

14 A. Schedule D-1.1 provides the details of Duke Energy Ohio and Duke Energy
15 Consolidated's total common equity as of June 30, 2021.

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

17 A. Schedule D-3A provides the details about the long-term debt position and cost of
18 Duke Energy Ohio's long-term debt as of June 30, 2021, which were used to
19 calculate the rate of return. Certain adjustments to the Company's long-term debt
20 were provided by Ms. Weatherston. Schedule D-3B provides details about the long-
21 term debt position and cost of long-term debt for Duke Energy as of June 30, 2021.

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

23 A. Schedule D-4A is used to provide the cost of preferred stock used to calculate the

1 rate of return; however, this schedule is submitted in blank form because Duke
2 Energy Ohio does not have preferred stock. Schedule D-4B provides details about
3 the preferred stock outstanding and cost of preferred stock for Duke Energy as of
4 June 30, 2021.

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

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

VII. CONCLUSION

11 **Q. WERE SUPPLEMENTAL FILING REQUIREMENT (C)(2) AND**
12 **SCHEDULES D-1A, D-1B, D-1.1, D-3A, D-3B, D-4A, D-4B, AND PAGE**
13 **THREE OF SCHEDULE D-5A AND D-5B PREPARED BY YOU OR**
14 **UNDER YOUR SUPERVISION?**

15 A. Yes.

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

19 A. Yes.

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

21 A. Yes.

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Summary: Testimony Direct Testimony of Christopher R. Bauer electronically filed by Mrs. Tammy M. Meyer on behalf of Duke Energy Ohio Inc. and D'Ascenzo, Rocco and Kingery, Jeanne W. and Vaysman, Larisa and Elizabeth M. Brama