

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Duke Energy Ohio, Inc., for an Increase in Natural Gas Rates.)	Case No. 22-507-GA-AIR
)	
In the Matter of the Application of Duke Energy Ohio, Inc., for Approval of an Alternative Form of Regulation.)	Case No. 22-508-GA-ALT
)	
In the Matter of the Application of Duke Energy Ohio, Inc., for Tariff Approval.)	Case No. 22-509-GA-ATA
)	
In the Matter of the Application of Duke Energy Ohio, Inc., for Approval to Change Accounting Methods.)	Case No. 22-510-GA-AAM
)	

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

July 14, 2022

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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 526 South
3 Church Street, Charlotte, North Carolina 28202.

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

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

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

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

CHRISTOPHER R. BAUER, DIRECT

1 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. Yes. I recently provided testimony in support of Duke Energy Ohio's Application
13 for an increase in electric distribution rates, tariff approval, and change in accounting
14 methods in Case Nos. 21-0887-EL-AIR, *et al.*

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

17 A. My testimony will address Duke Energy Ohio's financial objectives, credit
18 quality, capital structure, and cost of capital. Throughout my testimony, I will
19 emphasize the importance of Duke Energy Ohio's continued ability to meet its
20 financial objectives and maintain strong credit quality. In that regard, I sponsor
21 Rate of Return Schedules D-1A (Duke Energy Ohio) and D-1B (Duke Energy
22 Consolidated), Common Equity Schedule D-1.1, Embedded Cost of Short-Term
23 Debt Schedule D-2A (Duke Energy Ohio), Embedded Cost of Long-Term Debt

1 Schedules D-3A (Duke Energy Ohio) and D-3B (Duke Energy Consolidated),
2 Embedded Cost of Preferred Stock Schedules D-4A (Duke Energy Ohio) and D-
3 4B (Duke Energy Consolidated) and page 3 of Comparative Financial Data
4 Schedules D-5A (Duke Energy Ohio Consolidated) and D-5B (Duke Energy
5 Consolidated).

**II. DUKE ENERGY OHIO'S CAPITAL STRUCTURE AND FINANCIAL
OBJECTIVES**

6 **Q. WHAT WAS DUKE ENERGY OHIO'S CAPITAL STRUCTURE AS OF**
7 **MARCH 31, 2022?**

8 A. Duke Energy Ohio's capital structure as of March 31, 2022, was 47.66 percent long-
9 term debt, 0 percent preferred stock, and 52.34 percent common equity as detailed
10 on SFR Schedule D-1A.

11 **Q. WHY IS IT MORE APPROPRIATE TO USE DUKE ENERGY OHIO'S**
12 **CAPITAL STRUCTURE THAN DUKE ENERGY OHIO'S**
13 **CONSOLIDATED CORPORATE CAPITAL STRUCTURE?**

14 A. The capital structure being proposed in this case reflects that of the regulated
15 operating company, Duke Energy Ohio, and not that of the Parent (Duke Energy
16 Ohio Consolidated). Duke Energy Ohio primarily issues senior secured debt, which
17 is assigned an individual credit rating by Moody's and S&P. Utilizing the capital
18 structure of the Duke Energy Ohio regulated utility assures that Ohio customers are
19 paying only for Ohio's cost of debt, and therefore the Company feels it is more
20 appropriate to use the Duke Energy Ohio capital structure in this case.

1 **Q. WHAT ARE DUKE ENERGY OHIO’S FINANCIAL OBJECTIVES?**

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

14 **Q. WHAT RATEMAKING TREATMENT IS BEING REQUESTED IN THIS**
15 **PROCEEDING AND HOW WILL THE COMPANY’S FINANCIAL**
16 **OBJECTIVES BE IMPACTED?**

17 A. As explained by Duke Energy Ohio witness Amy B. Spiller, Duke Energy Ohio
18 proposes to increase our natural gas base rates to increase our annual natural gas
19 base revenues for our natural gas business by approximately \$49 million, which
20 results in an approximate 5.6 percent average increase to the customer’s total bill.
21 As part of this request, supported by the analysis and testimony of Duke Energy
22 Ohio witness James Coyne, the Company is requesting an allowed Return on
23 Equity (ROE) of 10.3 percent. The proposed capitalization in this request

1 comprises 47.66 percent long-term debt and 52.34 percent equity. Approval of the
2 Company's request in this case will support its financial objectives by ensuring
3 timely cash recovery of its prudently incurred costs.

III. CREDIT QUALITY & CREDIT RATINGS

4 **Q. PLEASE EXPLAIN CREDIT QUALITY AND CREDIT RATINGS, AND**
5 **HOW THEY ARE DETERMINED.**

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

11 Many qualitative and quantitative factors go into this assessment. Qualitative
12 aspects may include Duke Energy Ohio's regulatory climate, its track record for
13 delivering on its commitments, the strength of its management team, its corporate
14 governance, its operating performance, and its service territory. Quantitative
15 measures are primarily based on operating cash flow and focus on Duke Energy
16 Ohio's ability to meet its fixed obligations (interest expense, in particular) on the
17 basis of internally generated cash and the level at which Duke Energy Ohio
18 maintains debt balances. The percentage of debt to total capital is another example
19 of a quantitative measure. Creditors and credit rating agencies view both qualitative
20 and quantitative factors in the aggregate when assessing the credit quality of a
21 company.

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

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

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

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

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

18 There are four key factors that drive the credit ratings of the electric and gas
19 utility sector: regulatory framework, ability to recover costs and earn returns,
20 diversification, and financial strength. Obligations carrying a credit rating in the

1 “A” category are considered strong, investment-grade securities subject to low
2 credit risk for the investor. “A” rated debt is presumed to be somewhat susceptible
3 to changes in circumstances and economic conditions; however, the debt issuer’s
4 capacity to meet its financial commitments is considered strong. By contrast,
5 ratings in the “BBB” category are considered adequate and have less assurance of
6 access to the capital markets in challenging market conditions.

7 S&P may also modify its ratings with the use of a plus or minus sign to
8 further indicate the relative standing within a major rating category. An “A+”
9 credit rating is at the higher end of the “A” credit rating category and an “A-” is at
10 the lower end of the category. Moody’s credit rating assignments use the numbers
11 “1”, “2” and “3”, with the numbers “1” and “3” analogous to a “+” and “-”,
12 respectively. For example, Moody’s credit ratings of “A2” and “A3” would be
13 analogous to “A” and “A-” credit ratings at S&P, respectively.

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

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

21 A. To assure reliable and cost-effective service, and to fulfill its obligations to serve
22 customers, the Company must continuously plan and execute major capital projects.
23 This is the nature of regulated, capital-intensive industries like electric and gas

1 utilities. The Company must be able to operate and maintain its business without
2 interruption and refinance maturing debt on time, regardless of financial market
3 conditions. The financial markets continue to experience periods of volatility, most
4 recently driven by global inflation and other macro-economic factors. Duke Energy
5 Ohio must be able to finance its needs throughout such periods and strong
6 investment-grade credit ratings provide the Company greater assurance of continued
7 access to the capital markets on reasonable terms during periods of volatility.

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

10 A. With respect to the regulated transmission and distribution businesses of Duke
11 Energy Ohio, the rating agencies believe the Ohio regulatory environment generally
12 supports long-term credit quality with timely and sufficient recovery of prudently
13 incurred costs and expenses. S&P has maintained Duke Energy Ohio's business risk
14 profile of "Excellent" since the Company's sale of its merchant generation assets in
15 2015. Generally speaking, the credit rating agencies have identified the following
16 Strengths and Challenges when assessing the credit quality of Duke Energy Ohio:

17 • Credit Strengths:

- 18 ○ Lower risk regulated electric and natural gas utility operations,
- 19 ○ Supportive regulatory framework that includes riders for cost
20 recovery; and
- 21 ○ Large customer base provides stability to its cash flows.

22 • Credit Challenges:

- 23 ○ Sizeable, forecasted capital program indicates external funding needs

1 and will maintain pressure on credit metrics.

2 The rating agencies speak to the importance of a constructive regulatory
3 framework and the outcomes of future rate cases as areas of focus. Such
4 comments highlight the importance of the outcome of these proceedings in
5 supporting credit quality and the Company's financial objectives. S&P's outlook
6 of "stable" is predicated on the expectation that Duke Energy and its subsidiaries
7 will be able to manage regulatory risk while capital spending remains high.
8 Moody's affirmed Duke Energy and its subsidiaries' senior unsecured Baa1 rating
9 and stable outlook in April 2022.

IV. CAPITAL STRUCTURE AND COST OF CAPITAL

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

11 A. As mentioned earlier in my testimony, Duke Energy Ohio's proposed capital
12 structure comprises 47.66 percent long-term debt and 52.34 percent equity, after
13 adjusting for purchase accounting and other items. The Company believes this
14 proposed capital structure is appropriate for Duke Energy Ohio, as it introduces an
15 appropriate amount of risk due to leverage and minimizes the weighted average cost
16 of capital to customers. Approval of the proposed capital structure will help Duke
17 Energy Ohio maintain its credit quality to meet its ongoing business objectives. This
18 level is also consistent with the Company's target credit ratings.

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

20 A. Mr. Coyne testifies that the Company's cost of equity is in the range of 9.21 percent
21 to 11.12 percent with a four-model average of 10.05 percent using current interest
22 rates and 10.24 percent using projected interest rates. The Company supports Mr.

1 Coyne's analysis and is requesting 10.3 percent as the Company's allowed ROE.

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

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

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

21 A. Capital structure and return on equity are important components of credit quality.
22 Equity capital is subordinate to debt capital, thereby providing cushion and safer
23 returns for debt investors. Accordingly, equity capital is a more expensive form of

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

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

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

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

3 A. Duke Energy Ohio's weighted-average cost of long-term debt as of March 31, 2022,
4 is 4.07 percent.

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

5 **Q. HOW WILL DUKE ENERGY OHIO'S CAPITAL REQUIREMENTS BE**
6 **FUNDED?**

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

VI. **SCHEDULES, FILING REQUIREMENTS AND**
 INFORMATION SPONSORED BY WITNESS

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

14 A. Schedule D-1A is a summary showing the calculation of the rate of return on rate
15 base being proposed in this case for Duke Energy Ohio. Schedule D-1B is a similar
16 summary of the rate of return using Duke Energy's capital structure. The
17 accumulated deferred income tax and accumulated deferred investment tax credit
18 balances were derived from Schedule B-6, supported by Duke Energy Ohio witness
19 John R. Panizza. The adjustments to the capital structure were provided by Duke
20 Energy Ohio witness Brian Manges. I sponsor the information being used for the

1 calculation of the debt component and Mr. Coyne provided the rate of ROE.

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

3 A. Schedule D-1.1 provides the details of Duke Energy Ohio's total common equity as
4 of March 31, 2022.

5 **Q. PLEASE DESCRIBE SCHEDULES D-2A.**

6 A. Schedule D-2A provides details about the short-term debt position for Duke Energy
7 Ohio as of March 31, 2022.

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

9 A. Schedule D-3A provides the details about the long-term debt position and cost of
10 Duke Energy Ohio's long-term debt as of March 31, 2022, which were used to
11 calculate the rate of return. Certain adjustments to the Company's long-term debt
12 were provided by Mr. Manges. Schedule D-3B provides details about the long-term
13 debt position and cost of long-term debt for Duke Energy as of March 31, 2022.

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

15 A. Schedule D-4A is used to provide the cost of preferred stock used to calculate the
16 rate of return; however, this schedule is submitted in blank form because Duke
17 Energy Ohio does not have preferred stock. Schedule D-4B provides details about
18 the preferred stock outstanding and cost of preferred stock for Duke Energy as of
19 March 31, 2022.

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

21 A. I sponsor page 3 of Schedule D-5A, which calculates the fixed charge coverage ratio
22 for Duke Energy Ohio for the last ten historical periods and the test period. Page 3 of
23 Schedule D-5B, which I also sponsor, shows the credit ratings history for several of

1 Duke Energy's rated entities over the last ten years and shows the calculation of
2 Duke Energy's fixed charge coverage ratio over that same time period.

VII. CONCLUSION

3 **Q. WERE SCHEDULES D-1A, D-1B, D-1.1, D-2A, D-3A, D-3B, D-4A, D-4B,**
4 **AND PAGE THREE OF SCHEDULE D-5A AND D-5B PREPARED BY**
5 **YOU OR UNDER YOUR SUPERVISION?**

6 A. Yes.

7 **Q. IS THE INFORMATION YOU SPONSORED IN THOSE**
8 **SUPPLEMENTAL FILING REQUIREMENTS AND SCHEDULES**
9 **ACCURATE TO THE BEST OF YOUR KNOWLEDGE AND BELIEF?**

10 A. Yes.

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

12 A. Yes.

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