

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.)	

SUPPLEMENTAL TESTIMONY OF

CHRISTOPHER R. BAUER,

ON BEHALF OF

DUKE ENERGY OHIO, INC.,

IN SUPPORT OF SETTLEMENT

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

September 22, 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 400 South
3 Tryon 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. ARE YOU THE SAME CHRISTOPHER R. BAUER THAT FILED**
11 **DIRECT TESTIMONY IN THESE PROCEEDINGS?**

12 A. Yes.

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

15 A. My Supplemental Direct Testimony describes and supports the Corrected
16 Stipulation and Recommendation filed on September 19, 2022 (Stipulation), in
17 these proceedings. I discuss how the Stipulation, as a total package is beneficial to
18 customers and in the public interest. In doing so, I discuss the importance of a
19 utility, as it relates to the public interest, having sufficient cash flows to enable it
20 to access capital markets and how the Stipulation, helps to further that interest.

II. SUMMARY OF THE STIPULATION AND THE COMMISSION'S THREE PART TEST

Q. PLEASE BRIEFLY SUMMARIZE THE STIPULATION IN THESE PROCEEDINGS.

A. The Stipulation resolves Duke Energy Ohio's request for an increase in its base distribution rates as filed in these proceedings by, among other things, arriving at an agreed upon overall revenue requirement, a capital structure based upon the Company's actual capital structure that existed at the date certain of its filing, and a reasonable rate of return. It is important to note that the agreed upon return is not a guarantee, but rather, represents an opportunity for the Company to earn such a return on the capital it invests in its electric distribution system. This settlement includes an overall increase in revenues for electric distribution service of approximately \$22.6 million, a 50.5 percent equity ratio, and a return on equity (ROE) of 9.5 percent. This produces an overall rate of return (ROR) of 6.86 percent. In addition, I am aware that the Stipulation contains numerous other provisions related to rate design, allocations, low income programs, and reliability commitments as well as other terms and conditions that provide benefit to customers and the public interest explained by Ms. Spiller and supported by other witnesses.

Q. ARE YOU FAMILIAR WITH THE COMMISSION'S THREE-PART TEST FOR CONSIDERING THE REASONABLENESS OF A STIPULATION?

A. I am aware that the Commission uses a three-part test whereby it evaluates a regulatory settlement under the following criteria: 1) is the settlement a product of serious bargaining among capable, knowledgeable parties; 2) whether the settlement violates any important regulatory principles or practices; and 3)

1 whether the settlement, as a package, benefit customers and the public interest.
2 For purposes of my testimony, I am focusing on the third component of the
3 criteria, whether the settlement package benefits customers and is in the public
4 interest. Company witnesses Spiller, Lawler, Hesse, D'Ascendis, and Sailers,
5 discuss the other criteria and settlement components.

6 **Q. DO YOU BELIEVE THE SETTLEMENT BENEFITS CUSTOMERS AND**
7 **IS IN THE PUBLIC INTEREST?**

8 A. Yes.

9 **Q. PLEASE EXPLAIN.**

10 A. As I previously stated in my Direct Testimony, financial strength and flexibility and
11 access to capital through all market conditions are necessary for Duke Energy Ohio
12 to provide cost-effective, safe, and reliable service to its customers. Thus, having a
13 financially strong and stable utility is a benefit to customers and is in the public
14 interest. It allows the utility to make necessary investments to operate its system and
15 have sufficient revenues to fund ongoing operations. And conversely, a utility that is
16 capital constrained or operates with a weakened balance sheet, lacks the ability to
17 invest in its system and make timely critical repairs. Moreover, a capital constrained
18 utility loses or has a greatly reduced access to capital markets at reasonable rates.
19 Such financial constraints are not in the public interest.

20 **Q. HOW DOES DUKE ENERGY OHIO MEASURE AND MAINTAIN ITS**
21 **FINANCIAL STRENGTH AND CAPITAL MARKET FLEXIBILITY?**

22 A. Duke Energy Ohio maintains specific targets that support financial strength and
23 flexibility, which include: 1) maintaining an equity component of the capital

1 structure that is supportive of Duke Energy Ohio's credit quality; 2) ensuring timely
2 recovery of prudently incurred costs; 3) maintaining sufficient cash flows to meet
3 obligations; and 4) maintaining a sufficient return on equity to fairly compensate
4 shareholders for their invested capital. The ability to attract capital (both debt and
5 equity) on reasonable terms is vitally important to the Company and its customers.

6 **Q. WHAT IS THE CURRENT STATUS OF DUKE ENERGY OHIO'S CREDIT**
7 **QUALITY?**

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

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

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

adequate and have less assurance of access to the capital markets in challenging market conditions.

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

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

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

A. Equity investors provide the foundation of a company’s capitalization by providing significant amounts of capital, for which an appropriate economic return is required. Duke Energy Ohio compensates equity investors for the risk of their investment by targeting fair and adequate returns, a stable dividend policy, and earnings growth. These are necessary to preserve ongoing access to equity capital. Returns to equity investors are realized only after all operating expenses

1 and fixed payment obligations (including debt principal and interest) of the
2 Company have been paid. Because equity investors are the last in priority to a
3 company's assets, their investment is at the most risk should the company suffer
4 any underperformance. For this reason, equity investors require a higher return on
5 investment. Equity investors expect utilities like Duke Energy Ohio to recover
6 their prudently incurred costs and earn a fair and reasonable return for their
7 investors. The Company's proposal in these proceedings supports this investor
8 requirement.

9 **Q. DOES DUKE ENERGY OHIO COMPETE FOR INVESTORS IN THE**
10 **CAPITAL MARKETS? PLEASE EXPLAIN.**

11 A. Yes. When evaluating investment alternatives, fixed income investors use a set of
12 criteria similar to that of the rating agencies. Fixed income investors will evaluate
13 both credit strengths and challenges to determine the overall risk of the investment.
14 Fixed income investors make investments for up to 30 years of duration and
15 therefore consistency and predictability of business risk including a stable regulatory
16 environment is of paramount importance. If the regulatory environment in Ohio
17 becomes unsupportive or unpredictable, investors would likely look to alternative
18 fixed income investments that provide similar returns with lower perceived risk. In
19 addition, if Duke Energy Ohio's credit rating is in jeopardy, the risk of investing in
20 the Company's debt securities would increase. In order to compensate for the
21 increased risk, investors would require a higher rate of return. This would increase
22 the cost of future debt issuances, which are passed through to customers. Just as the
23 Company must compete for capital among fixed income investors in the debt capital

1 markets, it must also be well positioned against its peers to attract equity capital. A
2 pivotal factor in any investment decision is the risk-return profile of the subject
3 company. Authorized ROE is of paramount importance because it sets a cap on the
4 regulated company's ability to earn a return on invested capital and share that return
5 with equity investors. If the Commission were to adopt an unreasonable ROE it
6 could negatively impact Duke Energy Ohio's ability to attract debt and equity capital
7 on reasonable terms, especially in times of financial stress or under volatile market
8 conditions.

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

11 A. Capital structure and return on equity are important components of credit quality.
12 Equity capital is subordinate to debt capital, thereby providing a cushion and safer
13 returns for debt investors. Accordingly, equity capital is a more expensive form of
14 capital. The Company seeks to maintain a level of equity in the capital structure
15 that ensures high credit quality, while minimizing its overall cost of capital. An
16 adequate ROE will allow the Company to generate earnings and cash flows to
17 properly compensate equity investors for their capital at risk while protecting debt
18 investors with a higher degree of credit quality. High credit quality improves
19 financial flexibility by providing more readily available access to the capital
20 markets on reasonable terms, and ultimately lower debt financing costs.

1 **Q. PLEASE EXPLAIN WHY MAINTAINING CREDIT QUALITY AND**
2 **CREDIT RATINGS ARE BENEFICIAL TO CUSTOMERS AND IS IN THE**
3 **PUBLIC INTEREST.**

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

16 **Q. PLEASE EXPLAIN THE CONCEPT OF FUNDS FROM OPERATIONS**
17 **(FFO) AND THE IMPORTANCE OF THE RATIO BETWEEN FFO AND**
18 **DEBT.**

19 A. The Funds from Operations (FFO) to Debt calculation is a key leverage metric
20 utilized by the credit rating agencies when determining the credit rating and rating
21 outlook of a company such as Duke Energy Ohio. The numerator of the equation
22 (FFO), also referred to as Cash Flow from Operations Pre-Working Capital (CFO
23 Pre-WC) by Moody's Investor Services (Moody's), is comprised of the operating

1 cash flows of the company with certain proprietary adjustments made by the
2 rating agencies. The denominator is the total debt of the company. The result of
3 the calculation is a percentage that represents the cash flows of the company,
4 generated annually compared to total leverage. To maintain the current 'A' and
5 'A2' ratings by S&P and Moody's respectively, certain downgrade thresholds for
6 this key metric have been established for which Duke Energy Ohio must remain
7 above. Unfavorable regulatory outcomes will negatively impact the calculation.
8 For example, a lower equity ratio would result in reduced FFO and higher
9 leverage. A lower allowed ROE would also lower FFO, weakening the key
10 metric. Moody's current rating outlook of 'Stable' for Duke Energy Ohio reflects
11 a credit supportive regulatory environment and the expectation that, going
12 forward, the utility will demonstrate a ratio of FFO to debt between 15 and 17
13 percent. Further, Moody's explains that factors that could lead to a downgrade
14 include a less supportive or less consistent regulatory environment, a reduction in
15 cash flow due to less favorable rate proceeding outcomes, operational issues, or
16 an increase in leverage leading the ratio of FFO to Debt to fall below 15 percent
17 on a sustained basis. Over the past three years, Duke Energy Ohio's credit metrics
18 have been negatively impacted by the effects of tax reform and increased debt
19 funding for capital expenditures. As of December 2021, the ratio of FFO to Debt
20 was 15.7 percent, which hovers closely to the 15 percent downgrade threshold.
21 Based on its most recent credit opinion, Moody's expects Duke Energy Ohio's
22 FFO to Debt to be maintained in the 15 to 17 percent range over the next two

1 years as the Company obtains rate relief for investments not currently being
2 recovered under riders or trackers.

3 **Q. PLEASE EXPLAIN HOW THE FINANCIAL TERMS OF THE**
4 **SETTLEMENT ARE CONSISTENT WITH THE FINANCIAL TARGETS**
5 **YOU OUTLINED.**

6 A. The Stipulation is consistent with the specific targets I described as it relates to
7 providing:

- 8 • An agreed upon capital structure that is consistent with the Company's
9 actual capital structure as of March 31, 2021, the date certain in these
10 proceedings;
- 11 • Resolving the revenue requirement issues via the Stipulation, including
12 recovery of prudently incurred investments necessary to provide safe,
13 reliable service to customers and the resetting of various riders that further
14 allow for timely recovery of costs going forward;
- 15 • Enabling the Company to continue to maintain sufficient cash flows through
16 the rates it collects to allow the Company to continue to invest in its system
17 and to attract additional capital needed in between rate cases;
- 18 • Providing an opportunity for a reasonable return through the agreed upon 9.5
19 percent ROE for investors and shareholders for the capital they invest in the
20 Company.

1 **Q. DO YOU BELIEVE THAT THE STIPULATED CAPITAL STRUCTURE,**
2 **REVENUE REQUIREMENT, AND RETURN IN THIS CASE ARE**
3 **SUFFICIENT TO ENABLE THE COMPANY TO ACHIEVE ITS**
4 **FINANCIAL STRENGTH AND CREDIT QUALITY OBJECTIVES?**

5 A. Yes. Duke Energy Ohio's equity component, as resolved by the Stipulation should
6 enable the Company to maintain its financial strength and flexibility. This level of
7 debt and equity in the capital structure would allow the Company to maintain its
8 current credit ratings which provide greater access to the capital markets through all
9 business cycles.

10 Likewise the stipulated Revenue Requirement is a signal to investors that the
11 Company is able to recover its costs to provide reasonable and reliable service to its
12 customers. Likewise, the ROE and corresponding ROR as agreed in the Stipulation
13 will allow the Company to continue to attract capital at a reasonable cost and
14 provide adequate returns to compensate shareholders and investors.

15 **Q. DO YOU BELIEVE THAT THE STIPULATION WILL PRODUCE**
16 **SUFFICIENT FUNDS FROM OPERATIONS TO MAINTAIN THE**
17 **COMPANY'S CURRENT CREDIT RATINGS?**

18 A. Yes. The Stipulation provides for adequate revenues for the Company to continue to
19 fund its operations and avoid over-leveraging its balance sheet. In addition, if the
20 Commission were to adopt this Stipulation, the rating agencies would view this as a
21 constructive settlement and continue to view the regulatory environment in Ohio as
22 supportive.

23

1 **Q. ARE YOU AWARE OF ANY COMPARABLE UTILITIES TO THAT OF**
2 **DUKE ENERGY OHIO IN TERMS OF SIZE OR CREDIT METRICS THAT**
3 **HAD DIFFICULTY ACCESSING THE CAPITAL MARKETS IN RECENT**
4 **YEARS?**

5 A. Yes. Beginning shortly after the onset of COVID-19 in March of 2020 and
6 continuing through June of 2020, there were over 15 corporate issuers, including
7 regulated utilities with slightly lower credit ratings that were unable to access the
8 debt capital markets at a time that issuers were trying to shore up liquidity positions
9 in light of rapidly declining market conditions. Entergy Corporation and
10 Appalachian Power both launched public debt offerings on March 17, 2020 and
11 March 20, 2020 respectively and had to cancel their deals only hours later as
12 investors were not willing to loan money to utilities with lower ratings at that time.
13 These examples of utilities not having access to the capital markets when needed
14 spotlights the importance of maintaining strong credit quality to ensure consistent
15 access to the capital markets through all conditions in order to provide ongoing safe
16 and reliable service to our customers.

17 **Q. PLEASE EXPLAIN HOW MAINTAINING SUFFICIENT RETURNS AND**
18 **ACCESS TO CAPITAL MARKETS IS BENEFICIAL TO CUSTOMERS**
19 **AND IS IN THE PUBLIC INTEREST?**

20 A. Maintaining sufficient returns and being able to access the capital markets through
21 all conditions is crucial for the Company and its customers as it allows the Company
22 to raise capital when needed on reasonable terms. Ultimately, adverse cash flow
23 impacts have an adverse impact upon customer rates – Duke Energy Ohio's

1 customers benefit through lower electric rates when the Company has lower
2 financing costs, ready access to capital, and more timely cash recovery of its
3 investments. To assure reliable and cost-effective service, fund infrastructure
4 projects, and refinance maturing debt, Duke Energy Ohio must be able to finance
5 without interruption, regardless of capital market conditions. The lack of access to
6 capital can force interruption of capital projects to the long-term detriment of
7 customers, and both the financial crisis of 2008-09 and the COVID-related market
8 volatility during 2020 illustrate the importance of maintaining financial strength and
9 flexibility. Although market conditions have improved somewhat from the extreme
10 volatility due to COVID-19, they remain uncertain, and increased volatility can
11 return at any time. Strong credit ratings result in lower debt costs for our customers
12 and greater assurance of access to capital, even in challenging market conditions.

13 **Q. IN YOUR OPINION, DOES THIS STIPULATION PROVIDE SUFFICIENT**
14 **RETURNS TO DUKE ENERGY OHIO SO TO MAINTAIN ADEQUATE**
15 **ACCESS TO CAPITAL MARKETS FOR THE BENEFIT OF**
16 **CUSTOMERS?**

17 **A.** Yes. The rating agencies view the constructiveness of the regulatory environment
18 (consistent and predictable rate making) and the Company's ability to recover
19 prudently incurred costs timely as important ratings criteria in their assessment of
20 the credit quality of Duke Energy Ohio. This Stipulation demonstrates this strong
21 credit attribute, and I believe its approval without material modification would be
22 viewed by the rating agencies as constructive and equitable. Such approval of the
23 Stipulation will support the Company's ability to maintain its healthy credit profile,

1 generate adequate cash flow to support its critical capital investments, and fairly
2 balance the needs of affordable electric rates for customers and an acceptable ROE
3 for equity investors. For these reasons, I believe the Stipulation is beneficial to
4 customers and is in the public interest.

III. CONCLUSION

5 **Q. DOES THIS CONCLUDE YOUR SUPPLEMENTAL DIRECT**
6 **TESTIMONY?**

7 **A. Yes.**

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Summary: Testimony Supplemental Testimony of Chris Bauer electronically filed by Mrs. Debbie L. Gates on behalf of Duke Energy Ohio Inc. and D'Ascenzo, Rocco O. Mr. and Kingery, Jeanne W and Vaysman, Larisa and Akhbari, Elyse