Dianne M. Triplett
DEPUTY GENERAL COUNSEL

April 2, 2024

VIA ELECTRONIC FILING

Mr. Adam J. Teitzman, Commission Clerk
Office of Commission Clerk
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

Re: Docket 20240025-EI, Petition for Rate Increase by Duke Energy Florida, LLC

Dear Mr. Teitzman,

Attached for filing on behalf of Duke Energy Florida, LLC's ("DEF") in the above-referenced docket is the Direct Testimony of Karl Newlin.

Thank you for your assistance in this matter. Please feel free to call me at (727) 820-4692 should you have any questions concerning this filing.

(Document 17 of 40)

Respectfully,

/s/ Dianne M. Triplett

Dianne M. Triplett

DMT/mw

Attachment

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CERTIFICATE OF SERVICE
Docket No. 20240025-EI

I HEREBY CERTIFY that a true and correct copy of the foregoing has been furnished by electronic mail this 2nd day of April, 2024, to the following:

/s/ Dianne M. Triplett
Dianne M. Triplett

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition for rate increase by Duke Energy Florida, LLC

Docket No. 20240025-EI

Submitted for filing: April 2, 2024

DIRECT TESTIMONY

OF

KARL W. NEWLIN

On behalf of Duke Energy Florida, LLC

I. <u>Introduction and Summary</u>

Q. Please state your name and business address.

A. My name is Karl W. Newlin. My business address is 525 South Tryon Street, Charlotte, North Carolina, 28202.

Q. By whom are you employed and in what capacity?

A. I am employed by Duke Energy Business Services, LLC ("DEBS") as Senior Vice President, Corporate Development and Treasurer. DEBS provides various administrative and other services to Duke Energy Florida, LLC, ("DEF" or the "Company") and other affiliated companies of Duke Energy Corporation ("Duke Energy").

Q. What are the duties and responsibilities of your position as Treasurer with DEF?

A. In my role as Treasurer, I am responsible for treasury-related services to Duke Energy and its subsidiaries, including DEF. I monitor trends in the investment markets and maintain key relationships with debt investors, analysts, and financial institutions. Under my supervision, the Treasury Department arranges and executes all capital raising and liquidity transactions, including credit facilities and commercial paper, debt securities, preferred and hybrid securities, and common stock, as well as daily cash management for Duke Energy and its subsidiaries. My responsibilities include managing Duke Energy and its subsidiaries' credit ratings and interactions with the major credit rating agencies, commercial banks, and the capital markets. I am also responsible for liability management and long-term investments.

Q. Please describe your educational background and professional experience.

A. I graduated from Southern Methodist University with a Bachelor of Business Administration degree in 1991. I subsequently received a Master in Business Administration degree from UCLA's Anderson School of Management in 1998. I am also a Chartered Financial Analyst.

In November 2018, I assumed the role of Senior Vice President, Corporate Development and Treasurer for Duke Energy. Previously, I served as Senior Vice President and Chief Commercial Officer for Duke Energy's natural gas business. In this role, I was responsible for gas commercial operations, which included supply, wholesale marketing, transportation and pipeline services, field customer service, sales and delivery, and business development. I was named to this position following Duke Energy's acquisition of Piedmont Natural Gas ("Piedmont") in October 2016.

I joined Piedmont in 2010 to manage Piedmont's strategic planning functions, new business development activities and joint venture investments. In November 2011, I was appointed to the position of Chief Financial Officer, assuming responsibility for Piedmont's accounting, controller, finance, treasurer, investor relations, insurance, credit policy, risk management and state regulatory affairs areas. Prior to joining Piedmont, I served as Managing Director of Investment Banking for Merrill Lynch & Co. in its New York and Los Angeles offices.

Q. Have you ever testified before the Florida Public Service Commission?

A. I have not previously testified before this Commission. However, I have testified before the North Carolina Utilities Commission on behalf of Duke Energy Carolinas, LLC, Duke Energy Progress, LLC, and Piedmont.

Q. What is the purpose of your direct testimony?

A. My testimony will address DEF's general financial objectives, and its requested capital structure, and cost of capital. I will also discuss the current credit ratings and forecasted capital needs of DEF explained in detail in the testimony of other DEF witnesses in this proceeding. Throughout my testimony, I will emphasize the importance of DEF's continued ability to maintain its financial strength and need for its requested capital structure and cost of capital to continue to provide cost-effective, safe, reliable, and increasingly cleaner electric service to its customers.

Q. Do you have any exhibits to your testimony?

A. No.

Q. Do you sponsor any schedules of the Company's Minimum Filing Requirements ("MFRs")?

A. Yes. I sponsor a portion or all of the following MFRs:

C-23	Interest in Tax Expense
C-24	Parent Debt Information
D-1a	Cost of Capital – 13 Month Average
D-1b	Cost of Capital – Adjustments
D-2	Cost of Capital – 5 Year History
D-3	Short-term Debt
D-4a	Long-Term Debt Outstanding
D-4b	Reacquired Bonds
D-5	Preferred Stock Outstanding
D-7	Common Stock Data
D-8	Financial Plans – Stock and Bond Issues

These MFR Schedules are true and correct, subject to being updated during the course of this proceeding.

Q. Please summarize your testimony.

A. As detailed in my testimony and the testimony of DEF's witnesses in this proceeding, DEF faces substantial capital needs over the next several years. To meet those capital needs, the Company will compete for capital in the open market and must appeal to debt and Duke Energy's equity investors to attract the capital it needs. As Dr. Roger Morin, a leading expert on utility finance, states, "[t]he … prices of debt capital and equity capital are set by supply and demand, and both are influenced by the relationship between the risk and return expected for those securities and the risks expected from the overall menu of available securities." Morin, Roger A., *Modern Regulatory Finance* (PUR

Books LLC 2021), at 27. Investors have a variety of investment opportunities available to them and require a return commensurate with the risk they incur. They will invest elsewhere if they feel the expected return provided by a company is inadequate, and lower credit quality weakens a company's attractiveness as an investment opportunity relative to companies with higher credit quality and similar return profiles. For this reason, it is critically important that the Company maintain strong, investment-grade credit quality to assure its financial strength and flexibility and ensure access to capital on reasonable terms.

The Company is making significant capital investments to provide cost-effective, safe, reliable, and increasingly cleaner electric service to its customers. The Company's proposed rate increase will allow it to recover prudently incurred costs for this investment, compete in the capital markets for needed capital for this investment on reasonable terms for DEF's customers, and preserve its financial standing with both equity and debt investors as well as the credit rating agencies, to the long-term benefit of customers.

II. DEF's Capital Structure and Financial Objectives

Q. What are DEF's financial objectives?

A. Financial strength and access to capital are necessary for DEF to provide cost-effective, safe, and reliable service to its customers. The Company, at all times, seeks to maintain its financial strength and flexibility, including its strong investment-grade credit ratings, ensuring reliable access to capital on reasonable terms. Specific objectives that support financial strength and flexibility include: (a) maintaining an adequate percentage of common equity for DEF on a financial capitalization basis as shown in Schedule D-1a of the MFRs; (b) ensuring timely recovery of prudently incurred costs; (c) maintaining sufficient cash flows to meet obligations; and (d) maintaining a sufficient return on equity to fairly compensate shareholders for their invested capital. The ability to attract capital (both debt and equity) on reasonable terms is vitally important to the Company and its customers, and each of these specific objectives helps the Company both to maintain its investment-grade credit ratings and to meet its overall financial objectives for the benefit of customers.

Q. What ratemaking treatment is being requested in this proceeding and how will the Company's financial objectives be impacted?

A. As explained in the Company's Petition and in the direct testimony of Witness Marcia Olivier, and as shown on MFR A-1, DEF is requesting an overall increase in revenue requirement of approximately $593 million in 2025, and incremental increases of approximately $98 million in 2026, and $129 million in 2027 ($820 million total increase in revenue requirement by 2027). On an FPSC-adjusted basis, the proposed capitalization in this request is comprised of 40.68 percent long-term debt and 45.61 percent equity in 2025, 40.58 percent long-term debt and 45.73 percent equity in 2026, and 39.57 percent long-term debt and 45.83 percent equity in 2027. The requested capital structure is further delineated in MFR Schedule D-1a and, in addition to long-term debt and equity, comprises short-term debt, customer deposits, investment tax credits, and deferred income taxes. The proposed capitalization in this request will help DEF maintain its investment-grade credit ratings and meet its overall financial objectives for the benefit of customers.

The Company's Return on Equity ("ROE") Witness, Adrien McKenzie, indicates that the Company's cost of equity capital is in the risk-adjusted range of 10.5 percent to 11.5 percent. Based on his quantitative and qualitative analyses including the risk profile of the Company, Witness McKenzie's view is that 11.15 percent is a reasonable and appropriate estimate of the Company's cost of equity capital. Approval of the Company's request in this case will support its financial objectives by allowing timely recovery of its investments in plant and equipment, providing sufficient cash flows to fund necessary capital expenditures and service debt, and providing a fair and reasonable return to equity investors.

III. <u>DEF's Credit Quality & Credit Ratings</u>

Q. Please explain credit quality and credit ratings, and how they are determined.

A. Credit quality (or creditworthiness) is a term used to describe a company's overall financial health and its willingness and ability to repay all financial obligations in full and on time. An assessment of DEF's creditworthiness is performed by two major credit rating agencies, Standard & Poor's ("S&P") and Moody's Investors Service ("Moody's"), and results in DEF's credit rating.

Many qualitative and quantitative factors go into this assessment. Qualitative aspects may include DEF's regulatory climate, its track record for delivering on its commitments, the strength of its management team, its operating performance, and the economic vitality and customer profile of its service area. Quantitative measures are primarily based on operating cash flow and focus on the level at which DEF maintains debt leverage in relation to its generation of cash and its ability to meet its fixed obligations (interest expense in particular) based on internally generated cash. The percentage of debt to total capital is another example of a quantitative measure. Creditors and credit rating agencies view both qualitative and quantitative factors in the aggregate when assessing the credit quality of a company.

Q. What is the role of regulation in the determination of the financial strength of a utility company?

A. Investors, investment analysts, and credit rating agencies regard constructive regulation as one of the most important factors in assessing a utility company's financial strength. These stakeholders want to be confident that the Company operates in a stable regulatory environment that will allow the Company to recover prudently incurred costs and earn a reasonable return on investments necessary to meet the demand, reliability, and service requirements of its customers and service area. Important considerations include the allowed rate of return, the cash quality of earnings, the timely recovery of capital investments, the stability of earnings, and the strength of its capital structure. Positive consideration is also given for utilities operating in states where the regulatory process is streamlined, the time lag in capital investment recovery is minimized through cost recovery mechanisms such as riders and trackers, and outcomes are equitably balanced between customers and investors.

Q. How are DEF's outstanding securities currently rated by the credit rating agencies?

A. As of the date of this testimony, DEF's outstanding debt is rated as follows:

Rating Agency	S&P	Moody's
Issuer / Corporate Credit	BBB+	A3
Senior Secured	A	A1
Outlook	Stable	Stable

Moody's rates Duke Energy and its individual subsidiaries on a standalone basis. Accordingly, there is no reason to believe that a downgrade or negative outlook as to a different Duke Energy subsidiary would have a corresponding negative impact upon DEF's credit ratings. S&P utilizes a family rating methodology, whereby the credit rating and outlook of the parent company, Duke Energy, is applied to each of the parent's subsidiaries. Similar to DEF, S&P's outlook on Duke Energy is "Stable."

Obligations carrying a credit rating in the "A" category are considered strong, investment-grade securities subject to low credit risk for the investor. "A" rated debt is presumed to be somewhat susceptible to changes in circumstances and economic conditions; however, the debt issuer's capacity to meet its financial commitments 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. (AA and Aa category ratings for S&P and Moody's, respectively, are stronger than A ratings.)

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). DEF's "Stable" outlook at Moody's and S&P means that those 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 qualitative or quantitative credit quality.

Q. What strengths and weaknesses have the credit rating agencies identified with respect to DEF?

A. The rating agencies believe DEF operates in a generally constructive regulatory environment that supports long-term credit quality and view the Company's previous history of approved regulatory settlements including multi-year rate plans and certain cost recovery mechanisms as credit supportive. However, the rating agencies have identified several challenges the Company faces in maintaining its credit ratings. In May 2023, Moody's identified several factors that could adversely impact the Company's financial metrics (specifically, cash flow coverage ratios), which, in turn, could affect its ratings.[1]

- Severe Storms: Moody's notes that DEF's service territory is prone to hurricanes and major storms. The frequency and intensity of these storms appear to be increasing and have negatively impacted the Company's financial metrics.
- Capital Expenditures: Moody's also notes elevated capital expenditures due primarily to initiatives to harden its system and to implement the clean energy plans, and while the Company has multiyear rate plans and rider mechanisms in place, there is still some regulatory lag since certain investments will not be recovered until the assets are placed in-service, which will negatively pressure credit metrics.
- Sustaining Weak Credit Metrics: Moody's specifically identifies DEF's weak 2022 credit metrics as a credit challenge. Deferred fuel costs, driven by high gas prices, and storm damage from Hurricane Ian resulted in 2022 credit metrics that were weak for DEF's rating. While Moody's expects

[1] *See* Moody's Investors Service, Credit Opinion, "Duke Energy Florida, LLC. Update to credit analysis," May 22, 2023 ("May 2023 DEF Report").

DEF's metrics to improve, continuing weak metrics present the risk of a downgrade.

- Environmental Considerations: Moody's measures DEF's exposure to environmental risk as highly negative, driven by its high exposure to storm-caused damage to physical assets. The May 2023 DEF Report also notes that DEF's fossil fuel generation fleet presents moderate exposure to carbon transition risk.

Granting the rate relief as requested by the Company in this proceeding would make significant progress in addressing Moody's identified concerns.

S&P identifies similar risks to Duke Energy and DEF in its June 2023 DEF report.[2] As of June 2023, S&P affirmed its credit rating and "Stable" outlook for Duke Energy and its subsidiaries, including DEF. S&P stated in its June 2023 Duke Energy Corporation report[3] as well as its June 2023 DEF report that the current rating and outlook for Duke Energy and its subsidiaries is predicated, in part, on Duke Energy's ability to achieve constructive regulatory and rate case outcomes across its six service territories and manage environmental risks through its clean energy transformation strategy.

Q. Do DEF's customers benefit from the Company's strong credit ratings?

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[2] *See* S&P Global Ratings, Research "Duke Energy Florida LLC," June 2, 2023 ("June 2023 DEF Report").

[3] *See* S&P Global Ratings, Research "Duke Energy Corp" June 8, 2023 ("June 2023 Duke Energy Report").

A. Yes. To ensure reliable and cost-effective service, and to fulfill its obligations to serve customers, the Company must continuously plan and execute major capital projects. This is the nature of regulated, capital-intensive industries like electric and gas utilities. The Company must be able to operate and maintain its business without interruption and refinance maturing debt on time, regardless of financial market conditions. The financial markets can experience periods of volatility, and DEF must be able to finance its needs throughout such periods. Strong investment-grade credit ratings provide DEF with greater access to the capital markets on reasonable terms during such periods of volatility.

Q. Can the physical risks of DEF's service territory impact DEF's credit quality?

A. Yes. DEF's service territory is prone to strong storms and hurricanes and its enhanced risk and susceptibility to storms as compared to other utilities around the nation is described further in the testimony of Witness Brian Lloyd. These extreme weather events can be unpredictable and recovery costs can amount to hundreds of millions of dollars. These costs can be partially mitigated due to regulatory mechanisms such as DEF's storm reserve, however readily available access to capital on reasonable terms is critical in times such as these. Even facing the threat of a hurricane, mobilization efforts can be large scale and very costly. Storm recovery and repair require large amounts of capital on very short notice which is why it is even more important for utilities such as DEF to maintain adequate liquidity and access to capital. The Commission has recognized the importance of a utility's overall capital structure and how it may contribute to the utility's "ability to provide customers reliable service at reasonable rates while weathering tropical and financial storms."[4] Moody's and S&P list extreme storms and environmental risks as threats to DEF's credit quality. Therefore, it is important that DEF maintain an appropriate overall capital structure to ensure continued access to the markets on favorable terms for the benefit of its customers.

IV. <u>DEF's Capital Structure and Cost of Capital</u>

Q. What is DEF's proposed capital structure?

A. DEF's proposed capital structure can be found in MFR Schedule D-1a. The proposed equity percentage in 2025, 2026 and 2027 on an FPSC-adjusted basis[5] is 45.61 percent, 45.73 percent, and 45.83 percent, respectively. MFR Schedule D-1a assumes a financial equity percentage of 53% (using common equity, long-term debt, and short-term debt). The Company believes this proposed capital structure is optimal for DEF, as it provides an appropriate amount of risk due to leverage while minimizing the weighted average cost of capital to customers. Approval of the proposed capital structure will help DEF maintain its credit quality, including its strong investment-grade credit ratings.

Q. Does the actual financial capital structure vary over time?

[4] Supplemental Final Order, Florida Public Service Commission, Docket No. 20210015-EI, Order No. PSC-2024-0078-FOF-EI at 14 (March 25, 2024).

[5] Includes investor sources of capital as well as customer deposits, accumulated deferred income taxes and investment tax credits.

A. Yes. It does. The specific debt/equity ratio will vary over time, depending on a variety of factors, including, among other things, the timing and size of capital investments and payments of large invoices, debt issuances, seasonality of earnings, and dividend payments to the parent company. The requested regulatory capital structure is consistent with the Company's financial objectives and overall plan to maintain its ability to finance operations at rates favorable for customers, and DEF will manage its capital structure within reasonable range of this base requested capital structure. As of December 31, 2023, DEF's 13-month average FPSC-adjusted capital structure was 37.73 percent long-term debt and 44.58 percent equity.

Q. What is DEF's cost of equity?

A. Witness McKenzie indicates that a reasonable and appropriate cost of equity for the Company is 11.15 percent. The Company supports Mr. McKenzie's analysis.

Q. What role do equity investors play in the financing of DEF, 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. DEF compensates equity investors for the risk of their investment in Duke Energy by targeting fair and adequate returns, a stable dividend, and earnings growth – these are all necessary to preserve access to equity capital. Returns to equity investors are realized only after all operating expenses and fixed payment obligations (including debt principal and interest) of the business have been paid. Because equity investors are the last to receive surplus earnings and cash flows, their investment involves significantly more risk. For this reason, equity investors require a higher return for their investment. Equity investors expect utilities like DEF to recover their prudently incurred costs and earn a fair and reasonable return for their investors. The Company's proposal in this proceeding supports this investor requirement.

Q. What effect does capital structure and return on equity have on credit quality?

A. Capital structure and return on equity are important components of credit quality. The greater the equity component of capitalization, the safer the returns are to debt investors, which translates into higher credit quality and lower borrowing costs. In addition, the allowed return on equity is important to the generation of earnings and cash flows. An adequate return on equity helps ensure equity investors receive fair compensation for their investment while also helping to protect the interests of debt investors.

A strong capital structure and an adequate return on equity provide balance sheet protection and cash flow generation to support high credit quality. High credit quality creates financial flexibility by providing more readily available access to the capital markets on reasonable terms, and ultimately lower debt financing costs. Conversely, a weak capital structure and an inadequate allowed return on equity produces lower earnings and cash flows, lowers credit quality, and may limit financial flexibility.

Q. Do you believe that DEF's requested capital structure has an adequate equity component to enable DEF to achieve the Company's financial strength and credit quality objectives?

A. Yes. DEF's equity component, as requested in this case, enables it to maintain current credit ratings and financial strength and flexibility. This level of equity enables the Company to tolerate different business cycles while also providing more confidence to the Company's lenders and bondholders. Like many utilities, DEF is in a period of significant capital investment necessary to provide cost-effective, safe, reliable, low-carbon service to its customers in a time of rising costs, load growth, and rapidly evolving state and federal requirements. The magnitude of its capital requirements dictates the need for a strong equity component of the Company's capital structure to ensure access to capital funding at reasonable terms. The capital structure being sought in this case will help enable DEF to maintain its current credit ratings and financial strength and flexibility, to the benefit of its customers.

Q. What is DEF's average cost of long-term debt?

A. DEF's average cost of long-term debt is projected to be 4.49 percent in 2025, 4.52 percent in 2026, and 4.63 percent in 2027, as shown in MFR Schedule D-

4a. In 2023, the average cost of long-term debt was 4.60 percent. Note that when DEF filed its MFRs with the 2021 Settlement Agreement, MFR Schedule D-1a showed a long-term debt cost rate of 4.02 percent. Therefore, DEF experienced nearly 60 basis points higher cost of long-term debt in 2023 than what was included in rates.

Following the onset of the COVID-19 pandemic in early 2020, the Federal Reserve ("Fed") implemented a zero-interest rate policy, which lasted until the Fed began aggressively hiking interest rates in March 2022 to combat rising inflationary pressures. During this two-year period of zero-interest rate policy, long-term U.S. Treasury ("UST") yields also declined to historically low levels with the 10-year UST rate reaching as low as 0.54 percent and the 30-year UST rate touching just below 1.00 percent. During this period of ultra-low interest rates, the Company continued to fund its capital requirements by locking in historically low interest rates with the issuance of long-dated securities. In doing so, the Company materially reduced its refinancing risk as only 7 percent of DEF's $9 billion long-term debt portfolio (excluding securitizations) will mature over the years of 2024-2027. DEF also entered into pre-issuance interest rate hedges during the period of low UST rates, allowing the Company to lock in low interest rates in anticipation of future debt issuances. With long-term UST rates now north of 4.00 percent, reaching levels not seen since 2007, the Company's long-term debt funding strategy should prove very beneficial to customers in the coming years. In addition to U.S. Treasury rates, it is also worth noting that credit spreads have been extremely volatile since 2022 and could continue to be, which also contributes to refinancing risks.

Q. What is DEF's average cost of short-term debt?

A. DEF's average cost of short-term debt is projected to be 3.25 percent in 2025 and 3.20 percent in 2026 and 2027, as shown in MFR Schedule D-3. In 2023, the average cost of short-term debt was 5.17 percent. The Company's short-term debt rate is comprised of two components: (1) interest expense paid on utility moneypool borrowings, and (2) interest income received from utility moneypool lending. Per MFR Schedule D-3, annual short-term debt interest is calculated as interest on moneypool borrowings less interest income received from DEF's lending into the moneypool. This annual short-term debt interest amount is divided by the 13-month average net moneypool position to calculate the cost of net short-term debt as shown in MFR Schedule D-3.

As previously noted, persistently high inflation following the easing of fiscal and monetary policy during the COVID-19 pandemic has led the Federal Reserve to undertake one of the most aggressive Federal Funds cyclical increases in its history, raising the Fed Funds rate over 500 basis points since March 2022. The 5.25 percent to 5.50 percent Fed Funds target range, at the time of this rate case filing, is the highest level since 2006. The inversion of the yield curve reflects the fact that short-term borrowing rates are currently higher than long-term borrowing rates. Short-term rates are expected to remain high, albeit at lower levels than experienced in 2023, as the Federal Reserve has signaled, they are willing to go to great lengths to curtail the 40-year high inflation the economy has recently experienced. While the Fed has signaled that the Fed Funds rate is likely to remain higher for longer, their most recent dot plot shows that rate cuts are anticipated to begin sometime in 2024 and continue over the 2025-2027 timeframe.

Q. What benefits do DEF customers enjoy by being a part of the broader Duke Energy family?

A. Customers of DEF enjoy several benefits attributed to being a subsidiary of the larger Duke Energy portfolio of utilities. DEF is a participant in Duke Energy's $9.0 billion Master Credit Facility and $6.0 billion commercial paper program, which provide DEF greater access to liquidity from highly reputable financial institutions and in the short-term money markets. The Utility Moneypool Agreement between DEF and the other Duke Energy utilities, as approved by the FERC, allows DEF to borrow short-term funds from participating entities at the 'AA' Industrial Commercial Paper Composite Rate, which is a lower rate than would otherwise be available to DEF as a stand-alone issuer. The Moneypool also grants DEF the ability to lend excess short-term funding to participating Duke Energy affiliates, excluding Duke Energy Corp., and DEF is able to generate interest income on these short-term loans. Under Duke Energy's $9.0 billion Master Credit Facility, DEF is able to borrow up to a maximum sublimit of $1.35 billion. Depending on DEF's cash position on a given day, the Company will either be in a borrowing or lending position with respect to the Utility Moneypool arrangement with the other regulated Duke Energy affiliates; the regulated utilities can never lend to the parent, Duke Energy Corp. Access to deeper pools of liquidity at lower borrowing costs have been particularly beneficial in recent years financing hurricane restoration costs and under-collected fuel balances. DEF also benefits from operational efficiencies as a result of shared corporate services.

V. <u>Funding of DEF's Forecasted Capital Requirements</u>

Q. What are DEF's capital requirements over the three test years?

A. DEF faces substantial capital needs over the next several years to add solar generation and energy storage capacity; make the energy grid even more reliable and resilient; improve the efficiency and flexibility of existing generating plants to help lower fuel costs while proactively managing the changing grid; and satisfy its debt maturities. The Company's total capital requirements for the three-year test period ended 2027 are projected to be approximately $8.8 billion. This amount consists of approximately $8.1 billion in projected capital expenditures and approximately $0.7 billion in debt retirements.

Q. How will DEF's capital requirements be funded?

A. DEF's capital requirements are expected to be funded from internal cash generation and the issuance of debt by the Company.

Q. Is it appropriate to consider Duke Energy Corporation's capital structure and cost of debt when determining the revenue requirement for DEF?

A. No. DEF funds its operations through retained earnings and the issuance of its own debt. The capital structure on its balance sheet is its true capital structure. The assets constructed by DEF to serve customers were financed in a manner consistent with the Company's capital structure as a regulated utility, not that of a parent-level holding company. For this reason alone, deriving a revenue adjustment based on the capital structure and debt costs of DEF's parent is not appropriate. Additionally, Duke Energy's capital structure is significantly influenced by strategic transactions, for example acquiring other companies such as Progress Energy and Piedmont Natural Gas. Transactions such as these have increased Duke Energy's diversity and scale, ultimately providing benefits to the Company and its customers. These strategic transactions have nothing to do with DEF's capital structure; therefore, taking them into account in DEF's capital structure will impact it for reasons unrelated to DEF's capital investments and DEF's capital ratio necessary to meet the need for DEF's investments.

Q. Does the Company understand that the Commission's current Rule 25-14.004, F.A.C. requires the Company to address whether or not a parent debt adjustment should be computed to adjust the Company's revenue

requirement?

A. Yes. The Company believes, however, that the rule is obsolete because the rule does not reflect the way regulated utilities like DEF now calculate income tax. The existing rule imputes the tax effect of parent interest that may never be deductible by the subsidiary for tax purposes. However, this imputed effect is unnecessary because prior to making the parent debt tax adjustment, the utility is making an interest reconciliation adjustment to recognize the interest that is inherent in the utility's FPSC-adjusted capital structure. This provides a match between capital structure interest and the tax effect considered in cost of service. Assuming the capital structure has been determined properly, the utility's interest has been properly addressed. Because the capital structure of a utility is always an issue in litigated base rate proceedings, it is fair to assume that each utility's capital structure has been properly set. The current rule is one-sided in its application, and results in the utility not being allowed the opportunity to recover its costs and earn its authorized ROE. Debt incurred by the parent is assumed to be that of the utility as a rebuttable presumption under the Commission rule but other capital components of the parent, retained earnings of its subsidiaries for example, are not recognized. The Company forecasts that this adjustment will continue to grow in a material manner over the next several years and believes a more reasonable approach is to compute DEF's tax expense on a stand-alone basis without making this adjustment.

Q. Has any outstanding parent debt been used to make equity contributions to

DEF?

A. No. In 2009, Progress Energy, Inc. issued $750 million of Senior Notes, in which a portion of the proceeds was used to fund DEF's capital expenditures through a $620 million equity contribution. Over the period of the next three years (2010-2012), DEF sent dividends totaling $730 million back to the parent company, essentially returning the capital that was infused from the parent in 2009. Additionally, the $750 million Progress Energy, Inc. 2009 bond issuance used to partially fund DEF consisted of two tranches which matured in 2014 and 2019. The debt is no longer on the parent company's books, and therefore no tax deduction has been taken on this debt since all tranches have 02now matured. No equity contributions have been made to DEF since 2009 and the parent debt used to make any historical equity contributions has since matured. DEF, therefore, has demonstrated the rebuttable presumption even under the current rule. DEF should not be required to recognize the impacts of its parent company's debt. Duke Energy merged with Progress Energy, Inc. in 2012. Again, since then, Duke Energy has purchased additional businesses such as Piedmont and acquired and sold a number of commercial businesses. The capital structure of the parent is diluted by additional strategic transactions and capital raising activities and it should not be considered in determining DEF's revenue requirement. These investments have nothing to do with DEF's capital structure.

Q. Does this conclude your direct testimony?

A. Yes.