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June 20, 2018

South Carolina Office of Regulatory Staff
1401 Main Street, Suite 900
Columbia, SC 29201

RE: DOCKET NO. 2017-305-E – Interpretation Letter of Baker Tilly's June 12, 2018 Report on the Potential Financial Ramifications on SCE&G of the Eight Scenarios in Commission Order No. 2018-102

To the Office of Regulatory Staff:

In connection with the request of ORS for Baker Tilly to prepare a letter that interprets our report issued June 12, 2018, this document provides an interpretation of that report on the potential financial ramifications that each of the eight scenarios in Commission Order No. 2018-102 could have on SCE&G.

Our summary interpretation is presented in this letter.

Summary of interpretations of each scenario

The following is a summary of our interpretation of each scenario. Our interpretations are computed on a pre-tax basis. Based on our interpretation of the scenarios, SCE&G will generate positive cash flows from operations at various levels for all of the scenarios except for Scenario 6.

Table 1 – Executive Summary of the Eight Scenarios

#	Description	Interpretation
1	**Suspend annual collection of Revised Rates and do not credit ratepayers $2 billion of previously collected revenues**	Under Scenario 1, beginning in ProForma 2018, SCE&G's annual cash flows from operations would be roughly $400 million lower than SCE&G's 2017 base year. The reduction in revenue will still result in positive operating cash flow to SCE&G over the period we reviewed (ProForma 2018 – 2021). Additionally, SCE&G would record an impairment charge for the outstanding CWIP balance associated with the V.C. Summer project (which is now recorded as a deferred debit). Thus, total equity of SCE&G will also be reduced by the write-off amount of $3.9 billion. Strategies that SCE&G could implement to offset the impact of this cash flow gap might include: > Temporarily reduce or eliminate dividend payments (which were $344 million in 2017) > Reduce annual capital improvements or adjust long-term capital project planning to meet the expected reduced cash flows > Reduce operating expenses

		Based on our experience, reducing operating expenses in a utility would increase cash flows but would not yield significant cash flow savings to close the annual $400 million cash flow gap, so the likelier options would be to reduce or eliminate dividends and temporarily reduce capital improvements or adjust long-term capital project planning to meet the expected reduced cash flows.
2	**Suspend annual collection of Revised Rates and credit ratepayers $2 billion of previously collected revenues over a four-year term**	Under Scenario 2, annual cash flows from operations would be $918 million lower than SCE&G's 2017 base year. SCE&G spends approximately $960 million annually for capital improvements and dividend payments. While dividends and capital improvement costs can be reduced, SCE&G annual debt principal and interest payments of $987 million are a fixed cost, as those payments must be made to bondholders unless the terms of the bond indentures that requires those payments are restructured. Generally, rating agencies use a weighted average analysis of up to 50 financial ratios to evaluate the financial health of an organization. In our experience, the ratio of Long-term Debt/Total Capitalization is one ratio that is weighted heavily in the ratings agencies' evaluation which simply compares total outstanding long term debt to the company's total capitalization. For example under this scenario, Moody's would rank SCE&G's ProForma 2021 Long-Term Debt/Total Capitalization ratio of 72% in the category of Caa. This rating would be defined as "speculative to near default"[1]. It is our interpretation of Scenario 2 that even if SCE&G reduces or eliminates shareholder dividends and substantially reduces capital improvements, its ability to fully pay debt principal and interest payments without restructuring its current debt load or increasing rates would be severely compromised.
3	**Assuming no CWIP recovery and no credit to ratepayers of $2 billion of previously collected revenues**	If no "CWIP recovery" is allowed, the assets become impaired identical to Scenario 1. When assuming no CWIP recover, we simply interpreted this, as SCE&G would not be able to recover any additional Revised Rates, which makes this Scenario identical to Scenario 1.
4	**Assuming no CWIP recovery and a credit to ratepayers of $2 billion of previously collected revenues over four years**	If no "CWIP recovery" is allowed and a credit to ratepayers is refunded, the assets become impaired identical to Scenario 2. When assuming no CWIP recover, we simply interpreted this, as SCE&G would not be able to recover any additional Revised Rates, which makes this Scenario identical to Scenario 2. From an overall impact perspective, we feel that Scenario 2 and 4 create the 2nd greatest financial hardship to SCE&G on a pretax basis based on the Scenarios reviewed.

[1] Moody's 2017 publication – *Regulated Electric and Gas Industry Rating Methodology -* https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1072530

5	**Assuming partial recovery of CWIP – Disallow CWIP back to each Revised Rates Date and no credit to ratepayers of $2 billion of previously collected revenues**	This scenario is an analysis of what the impact would be on SCE&G in removing the BLRA rate increases one by one from the most recent to the oldest Since the BLRA Revised Rates provide the revenue stream for SCE&G to recover the Carrying Costs of construction of V.C. Summer Units 2 & 3 and a Rate of Return on the construction costs, as each BLRA rate increase is removed, a corresponding impairment of the V.C. Summer construction costs occurs and the cumulative effect of the reduction in rates and the reduction in CWIP recovery is shown. Scenario 5 results in progressively larger operating losses. This is due to the need for SCE&G to record an impairment charge for each incremental disallowance of CWIP recovery as an order is removed from the analysis. Impairment charges are a non-cash charge and do not impact cash flows. Construction costs are not recorded as operating expenses and do not impact cash flows from operations. Cash flows from operations also progressively decrease as each order is removed and rates are reduced. The reduction in cash flows from operations under the removal of each order is the incremental increase in BLRA rates approved in that order. In other words, by the time the last order (Order 2009-104(A)) is removed from the analysis, the entirety of BLRA Revised Rates has been removed. This amount is $445 million. Under Scenario 5, SCE&G's ratio of Long-term Debt/Total Capitalization remains in the speculative category. Also, under Scenario 5, beginning with the removal of Order 2011-738, annual cash flows from operations would be $400 million lower than SCE&G's 2017 level of capital improvements and forecasted 2018 debt principal and interest payments. Strategies that SCE&G could implement to close this cash flow gap could include: > Reduce or eliminate dividend payments (which were $314 million in 2017) > Reduce annual capital improvements or adjust long-term capital project planning to meet the expected reduced cash flows > Reduce operating expenses The likelier options would be to reduce or eliminate dividends and reduce capital improvements or adjust long-term capital project planning to meet the expected reduced cash flows. Employing these measures may allow the utility to weather the outcome of Scenario 5.
6	**Assuming partial recovery of CWIP – Disallow CWIP back to each Revised Rates Date and a credit to ratepayers of $2 billion of previously collected revenues**	Under Scenario 6, SCE&G's ratio of Long-term Debt/Total Capitalization falls into near default category when Orders 2016-758, 2015-712, 2014-785, 2013-680(A) and 2012-761 are disallowed. SCE&G would also have significant cash flow shortfalls starting with the disallowance of Order 2015-712, with its cash shortfall reaching $2 billion. It is our interpretation that if Order 2015-712 would be disallowed, that even if SCE&G reduces or eliminates shareholder dividends and substantially reduces capital improvements, its ability to fully pay debt principal and interest payments without restructuring its current debt load or increasing rates would not be possible. The scenario appears to provide the largest financial hardship to SCE&G.

7	**Assuming full recovery of CWIP and no credit to ratepayers of $2 billion of previously collected revenues**	Scenario 7 provides cash flows from operations of $1.6 billion each year, which is nearly equivalent to its 2017 level of capital improvements and forecasted 2018 debt principal and interest payments. This scenario represents the most favorable financial impact for SCE&G and it is the current status quo, i.e. collection of the $37 million per month of revenues authorized under the BLRA and a continued recovery of CWIP costs.
8	**Assuming full recovery of CWIP and a credit to ratepayers of $2 billion of previously collected revenues over four years**	Annual cash flows from operations would be approximately $500 million lower than SCE&G's 2017 base year. After the refund period (4 years), annual cash flows from operations would increase by $445 million, providing what would appear to be adequate cash flows for capital improvements and bond principal and interest payments. Strategies that SCE&G could implement during the refund period to close this cash flow gap and better match cash flows from operations to the need for capital improvements and debt principal and interest payments include: > Reduce or eliminate dividend payments > Reduce capital improvements or delay certain projects until after the refund period > Reduce operating expenses Earnings and equity would be reduced significantly during the refund period. This would most likely impact funding available for capital improvements and reduce the ability to pay dividends to shareholders.

Should you have any questions, we would be happy to discuss them with you. Do not hesitate to contact me at russ.hissom@bakertilly.com or at 608 240 2361.

We appreciate the opportunity to serve you.

Thank you.

Very truly yours,

BAKER TILLY VIRCHOW KRAUSE, LLP

Russell A Hissom

Russell A. Hissom, CPA, CIA, CISA, Partner

Memorandum

June 21, 2018

From: Jay R. Jashinsky, CPA

To: Andrew Bateman, JD

Subject: Impairment of Base Load Review Act Construction Work in Process (CWIP).

Based upon a review of Accounting Standards Codification 980 and conversations with the outside consultants, it is our understanding that SCE&G is not necessarily required, under certain conditions, to impair CWIP.

So long as there is the possibility that SCE&G could recover CWIP costs in the future, SCE&G has the option not to impair the assets. Under ASC 980-360-35-3, SCE&G would conduct an evaluation of the potential for future cash flows through rates that would allow SCE&G to recover its costs and a return. The standard states, "that determination shall focus on the facts and circumstances related to the specific abandonment and shall also consider the past practice and current policies of the applicable regulatory jurisdiction on abandonment situations." Thus, SCE&G would make an evaluation based on its judgement as to whether the CWIP could be recovered in the future, then decide whether an impairment is warranted. The conservative approach would be to record an impairment if it believes that CWIP recovery is not guaranteed. Furthermore, pursuant to discussion with the outside consultant, it is ORS' understanding that, should only partial suspension of SCE&G's revised rates be required, a conservative approach taken by SCE&G may be to only impair the portion of CWIP that corresponds to suspended revised rates.

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June 21, 2018

VIA ELECTRONIC FILING

The Honorable Jocelyn Boyd
Chief Clerk/Administrator
Public Service Commission of South Carolina
101 Executive Center Drive
Columbia, SC 29210

RE: Baker Tilly Virchow Krause, LLP Report - Docket No. 2017-305-E, Order No. 2018-102 – Financial Impact Review of South Carolina Electric and Gas Under Scenarios Relative to the Base Load Review Act, S.C. Code 58-33-210

Dear Ms. Boyd:

This filing is the affidavit of Russell A. Hissom, CPA, Partner of Baker Tilly Virchow Krause, LLP regarding the report prepared by Baker Tilly titled *Docket No. 2017-305-E, Order No. 2018-102 – Financial Impact Review of South Carolina Electric and Gas Under Scenarios Relative to the Base Load Review Act, S.C. Code 58-33-210.*

You can reach me at 608 240 2361 or Russ.hissom@bakertilly.com if there are any questions. Thank you.

Sincerely,

Russell A Hissom

Russell A. Hissom, CPA, Partner

Cc: Andrew Bateman, Office of Regulatory Staff

BEFORE

THE PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA

DOCKET NO. 2017-305-E, ORDER NO. 2018-102

RE: Baker Tilly Virchow Krause, LLP June 12, 2018 Report - Docket No. 2017-305-E, Order No. 2018-102 – Financial Impact Review of South Carolina Electric and Gas Under Scenarios Relative to the Base Load Review Act, S.C. Code 58-33-210

AFFIDAVIT OF RUSSELL HISSOM

Personally appeared before me, the undersigned, Russell Hissom, who being duly sworn states as follows:

1. I am Russell Hissom, a Partner with Baker Tilly Virchow Krause, LLP. I am a Certified Public Accountant (CPA) licensed in Wisconsin since 1987. I have a Bachelors of Business Administration degree in accounting from the University of Wisconsin – Milwaukee awarded in 1982. My experience includes working with electric utilities over the past 35 years in the areas of financial audits and application of accounting standards.

2. I oversaw the preparation of the June 12, 2018 Baker Tilly Virchow Krause, LLP Report - *Docket No. 2017-305-E, Order No. 2018-102 – Financial Impact Review of South Carolina Electric and Gas Under Scenarios Relative to the Base Load Review Act, S.C. Code 58-33-210*

3. Baker Tilly Virchow Krause, LLP was engaged by the South Carolina Office of Regulatory Staff (ORS) to independently evaluate the financial impacts of various scenarios on South Carolina Electric and Gas (SCE&G) financial statements.

4. These scenarios were approved to be evaluated by the South Carolina Public Service Commission (Commission) in Docket No. 2017-305-E, Order No. 2018-102.

5. The scenarios in Order No. 2018-102 included:

    1. Suspend annual collection of Revised Rates and do not credit ratepayers $2 billion of previously collected revenues.
    2. Suspend annual collection of Revised Rates and credit ratepayers $2 billion of previously collected revenues over a four-year term.

3. Assuming no construction work in progress (CWIP) recovery and no credit to ratepayers of $2 billion of previously collected revenues.
4. Assuming no CWIP recovery and a credit to ratepayers of $2 billion of previously collected revenues over a four-year term.
5. Assuming partial recovery of CWIP – Disallow CWIP back to each Revised Rates Date and no credit to ratepayers of $2 billion of previously collected revenues.
6. Assuming partial recovery of CWIP – Disallow CWIP back to each Revised Rates Date and a credit to ratepayers of $2 billion of previously collected revenues over a four-year term.
7. Assuming full recovery of CWIP and no credit to ratepayers of $2 billion of previously collected revenues.
8. Assuming full recovery of CWIP and a credit to ratepayers of $2 billion of previously collected revenues over a four-year term.

6. The accounting principles included in our analysis in connection with the scenarios examined include those of the Financial Accounting Standards Board's (FASB) Accounting Standards Codification (ASC) relevant to this matter. This is the authoritative guidance followed by SCE&G. ASC 980 – *Regulated Operations* is the guidance followed in the utility industry and relevant to this matter.

7. In each scenario in the report, the relevant guidance from the accounting standards of FASB is provided as supporting evidence to the conclusions we reached.

8. Source information used in our analysis included public filings of the Commission and of SCE&G, including SCANA's 10 – K filing as of and for the year ended December 31, 2017 and SCE&G's FERC Form 1 regulatory filing for the year ended December 31, 2017 filed and dated May 18, 2018.

9. Our analysis was prepared net of any income tax effects.

10. Our engagement and reporting was conducted in accordance with Statement on Auditing Standards No. 122 Section 915, *Reports on Application of Requirements of an Applicable Financial Reporting Framework*.

11. The ultimate responsibility for the decision on the appropriate application of the requirements of accounting principles generally accepted in the United States of America for an actual transaction rests with the preparers of financial statements, who should consult with their continuing accountant.

12. Our conclusion on the appropriate application of the requirements of accounting principles generally accepted in the United States of America for the described specific transaction is based solely on the facts provided to us as previously described; should these facts and circumstances differ, our conclusion may change. Our report sets forth the opinions and conclusions of Baker Tilly Virchow Krause, LLP in regards to the matter.

13. SCE&G has testified to the Commission that eliminating the Revised Rates will cause great financial harm to the company, with a possibility of SCANA (the parent company) and/or SCE&G having to file for bankruptcy. It is our opinion that our analysis cannot determine the likelihood of a potential bankruptcy filing by SCANA or SCE&G and our report provides no opinion on the matter.

Russell A Hissom

Russell A. Hissom

SWORN to BEFORE me the 21st day of June, 2018

Patricia McNeill

Notary Public for State of Wisconsin
My Commission Expires: August 4, 2019

PATRICIA MCNEILL
Notary Public, State of Wisconsin
MY COMMISSION EXPIRES AUG 4, 2019