EXHIBIT 2

BatesWhite Economic Consulting
Report

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BATES WHITE
ECONOMIC CONSULTING

Preliminary Analysis of an Interim Reduction in SCE&G Rates

March 22, 2018

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Introduction and Summary

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INTRODUCTION AND SUMMARY

The Proposed Interim Rate Reduction

- SCE&G's announcement that it would abandon its partially-built V.C. Summer Nuclear Power Plant triggered a contentious debate on who should pay for the construction costs incurred to date.
- The answer to that important question can only come after the South Carolina Public Service Commission (the "PSC" or "Commission") holds comprehensive hearings and issues its ruling.
- In the interim, however, some have proposed that the approximately $445 million per year in rates that SCE&G now receives for its Summer Plant[1] be suspended until the Commission's final ruling; this would reduce the average retail customer's bill by about 18%.[2]

[1] Affidavit of Ellen Lapson, 3, Dec. 7, 2017, *Request of the Office of Regulatory Staff for Rate Relief to South Carolina Electric & Gas Company's Rates Pursuant to S.C. Code Ann. § 58-27-920*, Docket No. 2017-305-E. This amount would reduce to $413 million per annum should SCE&G continue to collect the cost of new transmission assets (Lapson Affidavit, note 1).
[2] The $445 million in revenue was approved in SCE&G's Request for Rate Relief, Docket 2017-305-E, September 26, 2017. In 2016, residential customers served on Rate 8 (the most common residential rate) using 1,000 kWh would pay an average of approximately 18% for the construction of the units. http://www.regulatorystaff.sc.gov/Documents/News%20Archives/6-28-16%20SCEG%20Revised%20Rates%20Filing.pdf

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INTRODUCTION AND SUMMARY

SCE&G's Response

- SCE&G has responded to proposals for rate reductions with language that warns of severe financial consequences – including bankruptcy.
- In its Reply Brief dated December 7, 2017, for example, after explaining that the legal standard requires rates to be "fair and reasonable," SCE&G states that the rates resulting from such a proposal would be:

  "demonstrably ***unreasonable*** because if imposed they will profoundly damage SCE&G's financial sustainability, endanger its ability to continue to operate as a viable utility, and prevent it from accessing the capital needed to serve customers." [3]

- Similarly, in its filing dated January 22, 2018, SCE&G stated that if such rates were imposed, "a cascading financial effect would force the Company into bankruptcy."[4]

[3] SCE&G's Reply Brief in Support of its Motion to Dismiss, *Request of the Office of Regulatory Staff for Rate Relief to South Carolina Electric & Gas Company's Rates Pursuant to S.C. Code Ann. § 58-27-920*, Docket No. 2017-305-E, 3.
[4] Letter from Chad Burgess, Counsel for SCANA K., to the Honorable Jocelyn Boyd, Chief Clerk/Administrator of the Public Service Commission of South Carolina (Jan. 22, 2018), 2.

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INTRODUCTION AND SUMMARY

Credit Rating Agencies' Responses

- On September 29, 2017, S&P reported that SCANA had adequate liquidity:

  "SCANA's liquidity benefits from stable cash flow generation and availability under its revolving credit facilities.

  Other support for our liquidity assessment includes the company's ability to absorb high-impact, low-probability events with limited need for refinancing; its flexibility to lower capital spending; sound bank relationships; solid standing in credit markets; and generally prudent risk management." [5]

- On September 29, 2017, Fitch stated:

  ". . . any **permanent** loss of BLRA-related revenues and associated write-offs would materially impair SCE&G's financial health." [6]

- On March 9, 2018, Moody's Investors Service stated:

  ". . . we believe SCE&G will ultimately be required to make considerable rate concessions to move forward, and we expect there is likely to be a material deterioration in SCE&G's and SCANA's financial position." [7]

[5] S&P Global, Standard & Poor's Credit Research, Sept. 29, 2017, 4.
[6] Fitch, "Fitch Downgrades SCANA to 'BB+' / SCE&G to 'BBB–'; Negative Watch Maintained," Sept. 29, 2017, 1 (emphasis added).
[7] Moody's, *Credit Opinion SCANA Corporation*, Mar. 9, 2018, 1.

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INTRODUCTION AND SUMMARY

Scope of Our Analysis

- We were asked by the South Carolina Senate to analyze the impact of an interim rate reduction for SCE&G. Currently SCE&G rates include $445 million for recovery of costs associated with the abandoned V.C. Summer nuclear project representing approximately 18% of an average customer's bill. The rate reduction would remove some or all of these costs and thus range from zero to 18%.
- To clarify, our analysis does not:
  - Address legal or constitutional issues,
  - Pre-judge PSC rulings, or
  - Dictate how SCANA would address an interim rate reduction.
- The analysis relies on publicly available information, and so necessarily does not consider the range of confidential information available in a full rate-setting proceeding, such as that currently underway at the PSC.

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INTRODUCTION AND SUMMARY

Questions Addressed in This Briefing

- To analyze the impact of an interim short-term rate reduction for SCE&G[8] we assess three questions:

1. **What actions are available to SCANA and/or SCE&G in response to an interim rate reduction?**
2. **What interim reduction in rates can be absorbed by SCANA and/or SCE&G without significantly increasing the likelihood of insolvency?**
3. **What are the estimated impacts on SCE&G financial metrics associated with various levels of rate reduction?**

[8] Throughout this presentation we refer to both SCE&G and SCANA. All financial indicators or metrics are company specific.

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INTRODUCTION AND SUMMARY

Possible SCE&G Responses

- In the short-term, SCE&G has options to replace revenues lost to an interim rate reduction:
  - Reduce dividends
  - Reduce capital expenditures
  - Increase short-term borrowing
- SCE&G's choice of which option or combination of options to use will have different impacts on customers and investors.
- SCANA has recently announced it will maintain its dividend at 2017 levels[9] and signaled a possible increase in both common equity and short-term borrowing.[10] SCE&G has initiated plans for new capital expenditures.[11]

[9] SCANA, "SCANA Reports Financial Results for Fourth Quarter and Full Year 2017 and Declares Dividend on Common Stock for First Quarter 2018," Feb. 22, 2018.
[10] SCANA Corporation, South Carolina Electric & Gas Company, Prospectus (Form S-3), SCANA Corporation Medium Term Notes and Common Stock and South Carolina Electric & Gas Company First Mortgage Bonds, Mar. 16, 2018.
[11] Electrify Europe, "SCE&G Files Application for New CCFT to Replace Railed Nuclear Project," Mar. 19, 2018, https://gastopowerjournal.com/regulationapolicy/item/8348-sce-g-files-application-for-to-build-ccgt-to-replace-failed-nuclear-project

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INTRODUCTION AND SUMMARY

SCE&G's Current Financial Metrics

- SCE&G's credit ratings as of March 12, 2018 are investment grade:
  - Moody's: Baa3 (with a negative outlook)
  - S&P: BBB (with a negative outlook)
  - Fitch: BBB- (noting the rating is evolving)
- A BBB/Baa rated utility is considered to be investment grade with adequate capacity to meet its financial commitments, but more susceptible to adverse economic conditions. The relative standing within the rating category is indicated by a plus sign or minus sign by S&P and Fitch. Moody's uses 1 (highest) to 3 (lowest) to modify the standing within the category.
- SCE&G has a debt to equity ratio that is comparable to other BBB-/BBB/BBB+ rated utilities.
- SCE&G's ability to service its debt, as measured by the portion of earnings used to pay interest, is comparable to other BBB-/BBB/BBB+ rated utilities.
- SCE&G's dividend payment is higher than most utilities rated in the BBB/Baa rating category. In 2017, SCE&G paid dividends in an amount equal to 10.4% of its revenues. The average electric utility paid in the range of 4.4% (BBB-) to 6.9% (BBB).[12]

12. Data from S&P Capital IQ; Bates White calculations.

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INTRODUCTION AND SUMMARY

Impact on Financial Metrics of an Interim Rate Cut

- The credit rating agencies have focused on three metrics in their analyses of the financial difficulties of SCANA and SCE&G:
  - **CFO Pre-W/C to Debt** (the ratio of cash from operations before changes in working capital, to debt)
  - **Debt to Capitalization** (the ratio of debt as a percentage of debt plus equity)
  - **Debt to EBITDAR** (the ratio of debt to earnings before interest, tax, depreciation, amortization, and rents)
- The first ratio would be within the range identified by Moody's as indicating a Baa rating even with a full 18% revenue reduction.
- The second ratio would not appear to violate SCANA's debt covenants, even with a permanent 18% revenue reduction.
- The third ratio would rise above a critical level identified by Fitch after an 18% revenue reduction, possibly resulting in a decline in the credit rating.

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INTRODUCTION AND SUMMARY

Interim Rate Reduction

- In 2017, SCE&G distributed $319 million in dividends to SCANA.[13] In January 2018, SCANA announced a continuation of its 2017 dividend of $344 million.[14]

- An interim rate reduction could be absorbed by a cut in dividends. A cut in the dividend payment is consistent with the financial principle that equity investors (shareholders) explicitly take on the financial risk of the corporations in which they invest, thus helping preserve SCANA's continued access to debt capital (e.g., corporate bonds).

- SCE&G may be able to achieve some level of interim rate reduction by delaying less-than-essential capital investments and/or tightening its expenditures on non-essential items; or by increasing short-term debt or equity (SCANA).

- In our view, an interim rate reduction of 13% can be absorbed by SCE&G and SCANA without significantly increasing the likelihood of insolvency. This reduction could be achieved entirely through a reduction in SCE&G's dividend payment and thus sets the minimum rate reduction. The actions ultimately taken by SCE&G and SCANA in response to the interim rate reduction could include various combinations of reductions in dividends or expenditures, and/or increases in short-term debt/equity.

[13] SCE&G paid dividends in the amount of $319 to SCANA in 2017. (SCANA, 2017 Annual Report (Form 10-K) (Feb. 28, 2018), 74.)
[14] SCANA noted that it requires Dominion's approval to increase dividends beyond this level. (SCANA, 2017 Annual Report (Form 10-K) (Feb. 28, 2018), 24.)

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SCE&G Current Financial Health

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SCE&G's Current Financial Metrics

SCE&G Long-Term Debt to Equity

Long-Term Debt to Equity by Current S&P rating			
	BBB-	BBB	BBB+
Number of Companies	9	8	21
Max	1.22x	1.18x	1.33x
75th percentile	1.04x	1.03x	1.03x
Mean	0.91x	0.93x	0.93x
25th percentile	0.71x	0.83x	0.84x
Minimum	0.71x	0.71x	0.39x
SCE&G (BBB)		0.95x	

- SCE&G has comparable leverage, i.e., debt relative to equity within the company's capitalization, to other BBB-/BBB/BBB+ rated utilities.
- As debt in capitalization increases, the potential for future financial trouble and inability to service the debt can arise.
- SCE&G's 2017 long term debt to equity ratio was 0.95, just under 1-for-1.
  - This level is consistent with the ratio of other similarly-rated utilities.
  - The ratio has been relatively stable in recent years.

Data Source: S&P Capital IQ.

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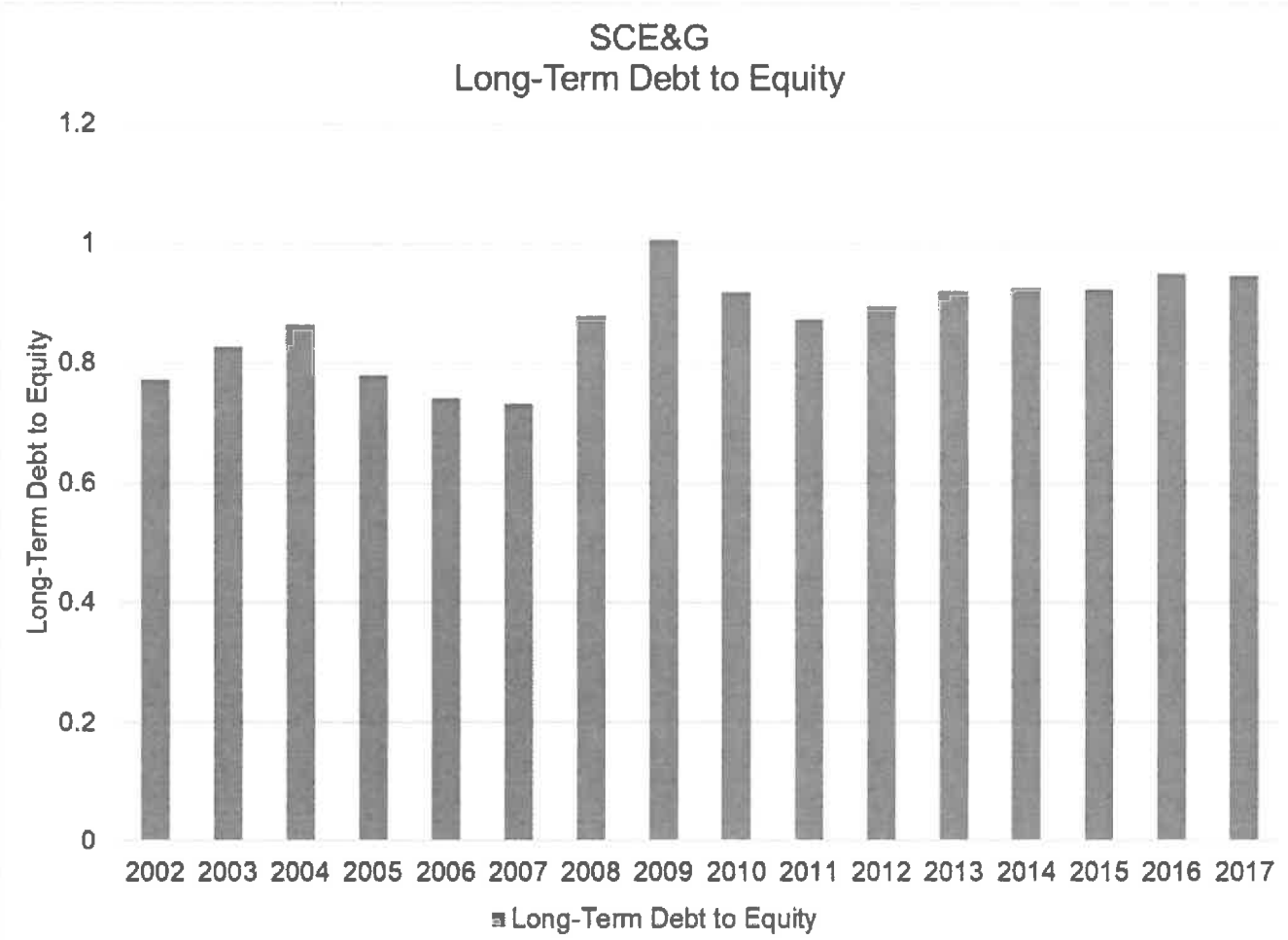
SCE&G's Current Financial Metrics

SCE&G Long-Term Debt to Equity



Data Source: S&P Capital IQ.

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SCE&G's Current Financial Metrics

SCE&G EBITDA to Interest Expense

EBITDA to Interest Expense by Current S&P rating			
	BBB-	BBB	BBB+
Number of Companies	9	8	21
Max	6.9x	7.3x	8.4x
75th percentile	5.3x	5.7x	7.0x
Mean	4.5x	5.6x	6.2x
25th percentile	3.0x	5.1x	5.3x
Minimum	2.3x	4.9x	3.7x
SCE&G (BBB)		4.6x	

- This ratio indicates that SCE&G has a ability to service its debt (pay interest) from current earnings comparable to that of other BBB-/BBB/BBB+ rated utilities.
- SCE&G's 2017 EBITDA-to-interest ratio of 4.6x is comparable to other BBB-/BBB/BBB+ rated utilities.
  - The ratio has been relatively stable in recent years.

Data Source: S&P Capital IQ.

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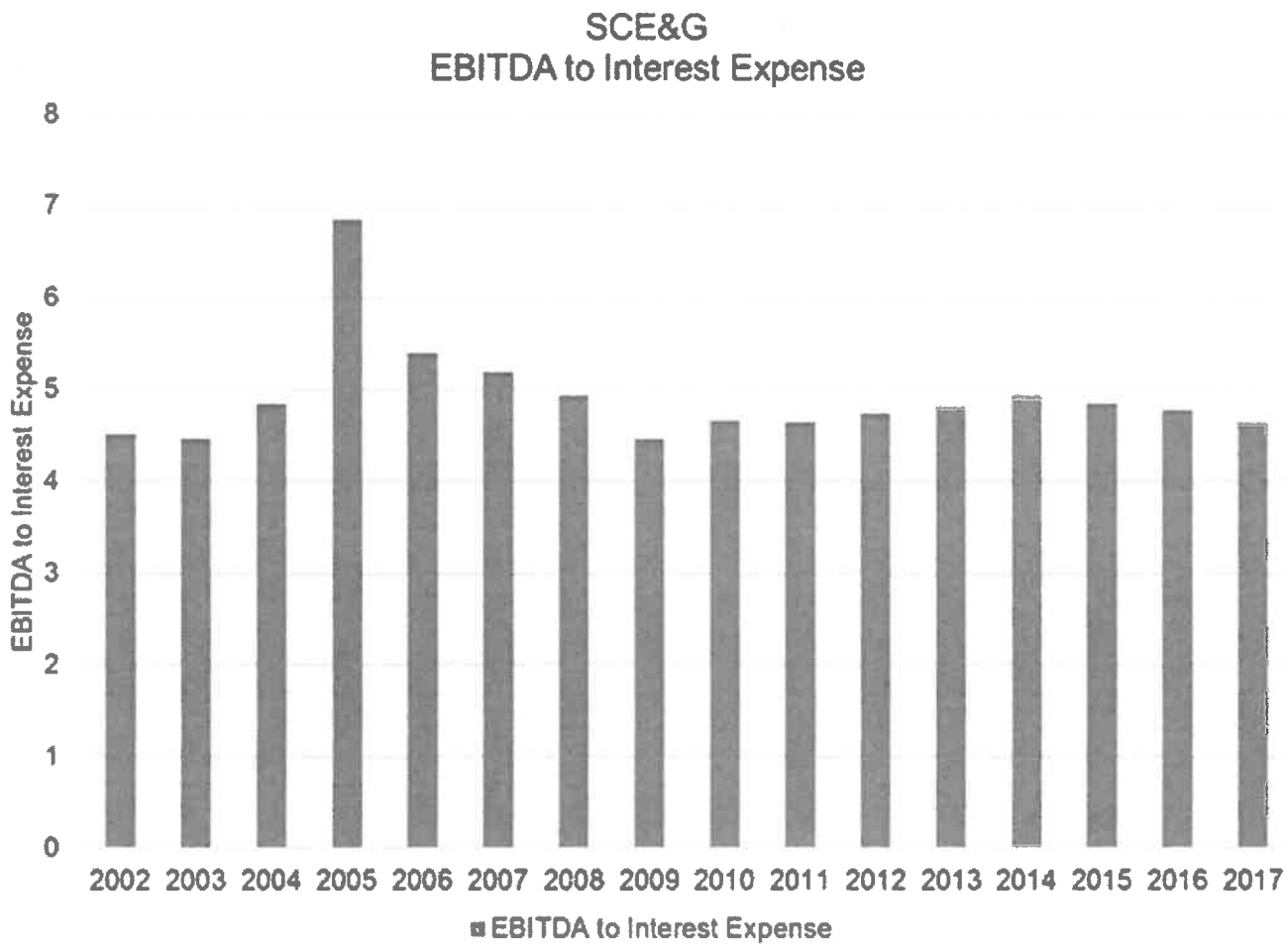
SCE&G's Current Financial Metrics

SCE&G EBITDA to Interest Expense



Data Source: S&P Capital IQ.

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Rating Agencies' Analyses

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RATING AGENCIES' ANALYSES

Key Metrics

- A company's financial health can be measured by a variety of metrics.
- Key metrics ultimately address the ability of a company to meet its financial obligations, and particularly payments to service debt.
- Insolvency is a condition in which a company cannot meet its obligation in a timely fashion. Insolvency does not necessarily lead to a state of bankruptcy, which is formal designation resulting from a court petition.
- Metrics addressing a company's financial health typically focus on:
  - The quantity of debt relative to the equity value of the firm (lower is better).
  - Revenue / cash flow relative to fixed obligations, or specifically to debt service needs (higher is better).
- Ratings agencies use a number of variations on these basic metrics.
- Financial metrics drive credit ratings, which, in turn, affect "access to capital" – the cost and availability of borrowing, and equity stock prices.

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RATING AGENCIES' ANALYSES

Moody's - Cash Flow

- In its March 9, 2018 Credit Opinion, Moody's noted the recent downgrades: While SCE&G was rated Baa3, the lowest investment grade rating, SCANA had fallen to a Ba1 rating, which is one notch below investment grade.[15]
- As already noted, Moody's stated its belief that SCE&G will face "considerable rate concessions" and that there will be "a material deterioration in SCE&G's and SCANA's financial position."[16]
- In that context, Moody's points to a metric calculated as (a) Cash From Operations excluding changes in Working Capital (CFO pre-W/C) divided by (b) Total Debt.[17]
- The higher this ratio, the more likely it is that the company will be able to service its debt.

[15] Moody's, "Credit Opinion," Mar. 9, 2018, 1.
[16] *Id.*
[17] *Id.*

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RATING AGENCIES' ANALYSES

Moody's – Cash Flow Metric

- In the same report, Moody's includes a chart showing this ratio for SCANA for the last five years – 2013 to 2017. That chart is reproduced in the next slide.
- For 2017, the chart reports Cash Flow (as measured by CFO Pre-W/C) of $1.293 billion and Total Debt of $7.196 billion for a ratio of 18.0%.
- For perspective, in two of the five years shown in Moody's chart, the ratio was in the low teens – the ratio was 12.6% in 2014 and 10.6% in 2015.
- This ratio falling into the low teens is not unprecedented even in this narrowly drawn historical record.
- For 2017, if $445 million in revenue had been suspended, this cash flow to debt ratio would have only fallen to 14.1%.[18] This value is consistent with a Baa rating from Moody's.[19]

[18] This assumes a 37.5% marginal tax rate as used by SCANA's witness Ms. Lapson.
[19] *Id.*, 7. Moody's indicates that values for this ratio between 11% and 15% would be consistent with a Baa rating.

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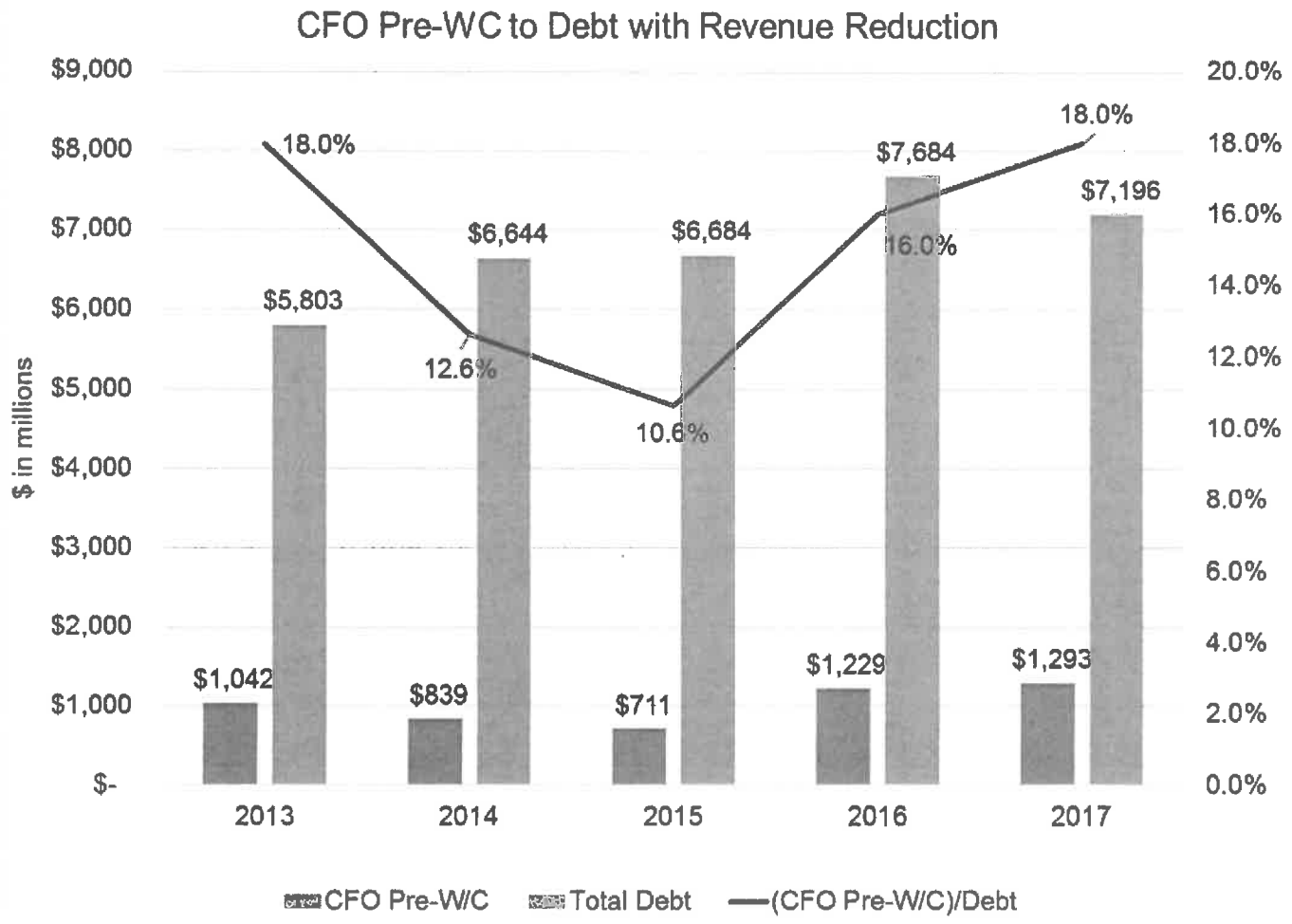
RATING AGENCIES' ANALYSES

SCANA CFO Pre-WC to Debt



Data Source: Moody's, "Credit Opinion", Mar. 9, 2018, 2.

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RATING AGENCIES' ANALYSES

Moody's – SCANA Use of Cash Flow

- Moody's points out that in fiscal year 2017, SCANA generated approximately $1.17 billion in cash flow from operations. Moody's reports that this cash flow was used to fund, in part, (a) capital expenditures of $1.23 billion and (b) dividend payments to shareholders of $344 million, resulting in a negative free cash flow of about $400 million.[20] SCANA used more cash than it generated.
- Similarly, for 2016, SCANA generated $1.1 billion in cash flow. It used cash for (a) $1.6 billion in capital expenditures and (b) $325 million in dividend payments. In 2016, SCANA had negative free cash flow of "approximately $800 million."[21]
- Moody's states, "given the abandonment decision, we expect capital expenditures to be reduced to about $700-800 million per year" such that SCANA will become "free cash positive."[22]

[20] Moody's, "Credit Opinion," Mar. 9, 2018, 8.
[21] *Id.*, 6.
[22] *Id.*

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RATING AGENCIES' ANALYSES

Moody's - Cash Flow to Debt Ratios for SCANA's Peers

- Moody's also presents a "Peer comparison" of this and other metrics.
- SCANA had cash flow to debt ratios over the three years, 2015 to 2017, ranging from 10.6% to 18%.[23]
- By comparison, according to Moody's:
  - Duke was in the range of 13.1% to 16.5%;
  - Southern was in the range of 9.2% to 20.6%; and
  - FirstEnergy was in the range of 12.3% to 14.2%.[24]

[23] *Id.*, 3.
[24] *Id.*, 7.

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RATING AGENCIES' ANALYSES

Moody's – SCANA Debt to Capitalization

- Moody's and SCE&G also point to another metric: the amount of debt as a percentage of capitalization.
- The concern is that some debt agreements have limits on this ratio.[25]
- One of SCANA's outside experts, Ms. Lapson, states:[26]

> "If the ratio of total debt to total capital as defined in the two credit agreements exceeds 70%, as may occur under certain scenarios, that would constitute an Event of Default, and any credit outstanding under those agreements would become immediately due and payable and no further credit would be available under the agreements."

- For the three-year historical record presented by Moody's[27], the debt share of capitalization for SCANA has varied in a narrow range – from 47.7% in 2015 to 52.6% in 2017.
- In its peer comparison, Moody's reports (a) for Duke, a range of 44.2% to 48%; (b) for Southern, a range of 47% to 55.5%; and (c) for FirstEnergy, a range of 58.8% to 73.5%.

[25] *Id.*, 6.
[26] Lapson Affidavit, 4–5.
[27] Moody's, "Credit Opinion," Mar. 9, 2018, 7.

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RATING AGENCIES' ANALYSES

Fitch

- On September 29, 2017, Fitch Ratings downgraded SCE&G's Long-term Issuer Default Rating (IDR) by one notch to BBB-, the lowest investment grade rating.[28] Fitch also downgraded the IDR of SCANA, SCE&G's parent, by one notch to BB+, one level below investment grade.[29]
- Fitch stated, "The rating downgrade primarily reflects the severe deterioration in the legislative and regulatory construct in SC in recent days."[30]
- Fitch cited the ORS filing "seeking immediate suspension of the revenues related to the new nuclear units."[31]
- In addition, Fitch noted the House and Senate-led critical review of the nuclear project as well as possible challenges to the constitutionality of the Base Load Review Act [BLRA].[32]

[28] Fitch, "Fitch Downgrades SCANA to 'BB+' / SCE&G to 'BBB–'; Negative Watch Maintained," Sept. 29, 2017, 1.
[29] *Id.*
[30] *Id.*
[31] *Id.*
[32] *Id.*

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RATING AGENCIES' ANALYSES

Fitch – Debt to EBITDAR

- Fitch often refers to a cash-flow measure that compares debt to the amount of money earned each year that can be used to repay that debt or EBITDAR (earnings before interest, tax, depreciation, amortization and rents). The lower this ratio – i.e., the higher earnings are relative to debt – the better a company's financial position.
- Fitch stated that the rating would stabilize if it saw SCANA's "adjusted debt/EBITDAR stabilizing at/or below 5.5x."[33]
- Fitch went on to say that SCANA's bond rating could be upgraded if that ratio "can be maintained at/or below 4.5x."[34]
- SCANA could suffer a downgrade if, among other things, the ratio, "consistently and materially [exceeded] 5.5x."[35]
- In a separate report dated October 18, 2017, Fitch stated that SCANA's "Total Adjusted Debt/Operating EBITDAR" ratio in the four years from 2013 to 2016 was between 4.2x and 4.7x.[36]

[33] *Id.*, 2.
[34] *Id.*
[35] *Id.*, 3.
[36] Fitch, Financial Summary, SCANA Corp., Oct. 18, 2017, 1.

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RATING AGENCY ANALYSES

Fitch - Liquidity

- In terms of broader liquidity, Fitch concluded that "SCANA has adequate financial flexibility, under Fitch's base case scenario, to meet its obligations over the next 12 months without accessing the capital markets."[37]
- Fitch later stated that "SCANA will be roughly FCF [Free Cash Flow] neutral in the next 12 to 18 months, including the loss of BLRA-related revenues but excluding Toshiba-related rebates."[38]
- Fitch also notes that "curtailment of dividend payments could provide up to $300 million of incremental liquidity, if needed."[39]

[37] Fitch, "Fitch Downgrades SCANA to 'BB+' / SCE&G to 'BBB–'; Negative Watch Maintained," Sept. 29, 2017, 3.
[38] *Id.*
[39] *Id.*

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Three Examples of Responses to Financial Difficulties

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THREE EXAMPLES OF RESPONSES TO FINANCIAL DIFFICULTIES

Ameren Corporation

- Ameren Corporation cut dividends in February of 2009 by 39% in a move to conserve cash and support financial coverage metrics. The decision was made in response to a weak economy and rising operating and maintenance costs in the utilities sector.[40,41]
- Additionally, Ameren announced a reduction in capital expenditures by $800 million in order to provide more financial flexibility.[42]
- Ameren's share price dropped by 17% in single day[43]
- Moody's applauded the move:

  "a conservative, prudent, and credit positive action that will conserve cash and support financial coverage metrics. It will also better position the company to manage increasingly challenging business and credit market conditions for utilities going forward."[44]

[40] Jeffrey Tomich, "Ameren Shares Plunge on News of Dividend Cut; the 17 Percent Drop Was Biggest in One Day since UE/Cipsco Merger Created Ameren in '98," *St Louis Post Dispatch* Feb. 18, 2009, http://www.stltoday.com/business/ameren-shares-plunge-on-news-of-dividend-cut-the-percent/article_1974ca4b-66bc-540f-94cd-df96db064ab7.html.
[41] Moody's, "Moody's Affirms Ameren Ratings; Dividend Credit Cut Is Credit Positive," Feb. 16, 2009, https://www.moodys.com/research/Moodys-Affirms-Ameren-Ratings-Dividend-Cut-Is-Credit-Positive--PR_172989.
[42] Jeffrey Tomich, "Ameren Shares Plunge on News of Dividend Cut; the 17 Percent Drop Was Biggest in One Day since UE/Cipsco Merger Created Ameren in '98," *St. Louis Post Dispatch*, Feb. 18, 2009, http://www.stltoday.com/business/ameren-shares-plunge-on-news-of-dividend-cut-the-percent/article_1974ca4b-66bc-540f-94cd-df96db064ab7.html.
[43] *Id.*
[44] Moody's, "Moody's Affirms Ameren Ratings; Dividend Credit Cut Is Credit Positive," Feb. 16, 2009, https://www.moodys.com/research/Moodys-Affirms-Ameren-Ratings-Dividend-Cut-Is-Credit-Positive--PR_172989.

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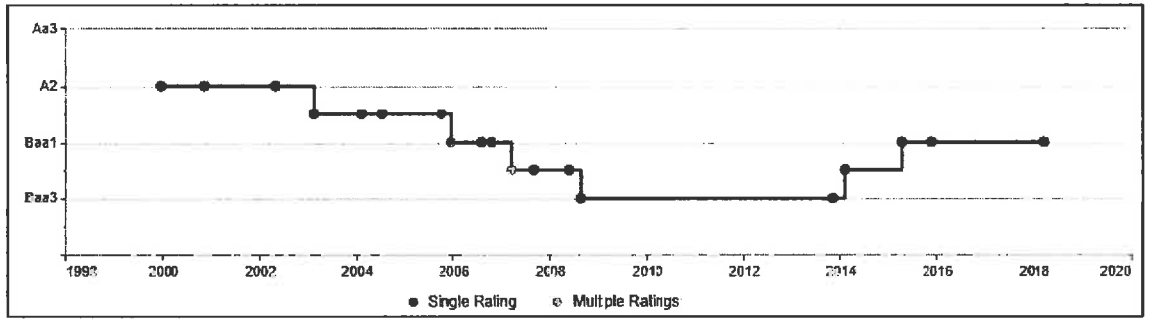
THREE EXAMPLES OF RESPONSES TO FINANCIAL DIFFICULTIES

Ameren Corporation

- Ameren's dividend cut brought its payout more in line with the utility average, while conserving ~$215 million per year in cash and reducing negative free cash flow.[45]
- Ameren shows that reductions in dividend payments can be met with positive reactions from creditors. Moody's reported:

  "Ameren's high dividend payout ratio [was a] credit constraining factor that has contributed to high levels of negative free cash flow and increased external financing needs."[46]
- The figure below shows Ameren's credit rating was stabilized in the 2009 to 2014 time period by virtue of the dividend cut, and eventually rose.[47]



[45] *Id.*
[46] *Id.*
[47] Moody's Investor's Service, Ratings, accessed Mar. 16, 2017. https://moodys.com

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THREE EXAMPLES OF RESPONSES TO FINANCIAL DIFFICULTIES

Pacific Gas and Electric Company

- In the third quarter of 2017, PG&E paid a dividend of $0.53/share for ~516 million shares, translating to ~$278 million per quarter or $1.1 billion per year. This amounts to approximately 6% of total revenue.[48]
- On December 20, 2017, PG&E Corporation (PCG) suspended its quarterly dividend to conserve cash in response to potential legal liability for California wildfires.49
- PG&E's share price dropped ~14% after the dividend suspension.[50]
- The next day, Moody's placed PG&E's credit rating under review for possible downgrade. The credit review was implemented mainly due to utility liability regulations in the state of California and uncertainty of liability related to wildfire.[51]
- On February 22, 2018, S&P downgraded PG&E's ratings from "A-" to "BBB+" on the wildfire risks.[52]

[48] Seeking Alpha.com, "PG&E: Dividend Suspension Makes Sense, Issues Remain Large," Dec. 22, 2017, https://seekingalpha.com/article/4133485-pg-and-e-dividend-suspension-makes-sense-issues-remain-large.
[49] PG&E Corporation, "PG&E Announces Suspension of Dividend, Citing Uncertainty Related to Causes and Potential Liabilities Associated with Northern California Wildfires," Dec. 20, 2017, http://investor.pgecorp.com/news-events/press-releases/press-release-details/2017/PGE-Announces-Suspension-of-Dividend-Citing-Uncertainty-Related-to-Causes-and-Potential-Liabilities-Associated-with-Northern-California-Wildfires/default.aspx .
[50] Seeking Alpha.com, "PG&E -14% after Dividend Cut But Some Analysts Say Worst May Be Over," Dec 21, 2017. https://seekingalpha.com/news/3319714-pg-and-e-minus-14-percent-dividend-cut-analysts-say-worst-may.
[51] Moody's. "Moody's Places PG&E Corporation and Pacific Gas & Electric Company's Ratings on Review for Downgrade," Dec. 21, 2017, https://www.moodys.com/research/Moodys-places-PGE-Corporation-and-Pacific-Gas-Electric-Companys-ratings--PR_377572.
[52] Seeking Alpha.com "PG&E Downgraded by S&P on Wildfire Risks," Feb. 22, 2018, https://seekingalpha.com/news/3333418-pg-and-e-downgraded-s-and-p-wildfire-risks

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THREE EXAMPLES OF RESPONSES TO FINANCIAL DIFFICULTIES

Pacific Gas and Electric Company

- According to Moody's, the dividend suspension, in itself, was viewed as credit positive; but, the downgrade was based mainly on a credit review of the wildfire liability of California companies. Moody's release on the credit review states:

  "While a dividend suspension will bolster liquidity and strengthen the balance sheet for both PCG and PG&E, the BOD's decision suggests that they view the uncertainty liability associated with wildfire-related damages to be so extensive, that it may exceed liquidity reserves as well as impact the company's ability to access the capital markets, and potentially the solvency of the utility."[53]

- PG&E shares rose over 7% in March, on news of updates to liability rules and regulations for utilities in the state of California.[54]

[53] Moody's, "Moody's Places PG&E Corporation and Pacific Gas & Electric Company's Ratings on Review for Downgrade," Dec. 21, 2017, https://www.moodys.com/research/Moodys-places-PGE-Corporation-and-Pacific-Gas-Electric-Companys-ratings--PR_377572.
[54] Seeking Alpha.com, "PG&E, Edison Surge after California to Work Toward Updating Liability Rules," https://seekingalpha.com/news/3338833-pg-and-e-edison-surge-california-work-toward-updating-liability-rules.

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THREE EXAMPLES OF RESPONSES TO FINANCIAL DIFFICULTIES

Mississippi Power

- In February 2018, Mississippi Power and its parent Southern Company settled a case with the Mississippi Commission on cost recovery for its Kemper County IGCC Power Plant – one of a very few "clean coal" projects in the U.S.[55]
- Under the settlement, Mississippi Power will have no cost recovery for the abandoned portion of the Kemper Plant – the portion related to the gasification process that suffered significant delays and cost increases. That amounts to about a $6.4 billion disallowance out of the approximately $7.5 billion total capital cost.[56]
- Mississippi also had similar legislation in place, i.e., the Base Load Act.

[55] Order Approving Second Amended and Restated Stipulation, *In re: Encouraging Stipulation of Matters in Connection with the Kemper County IGCC Project,* Docket No. 2017-AD-112 (Mississippi Public Service Commission, Feb. 6, 2018).
[56] *Id.*, ¶¶ 96, 139.

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THREE EXAMPLES OF RESPONSES TO FINANCIAL DIFFICULTIES

Mississippi Power – Relevance for SCE&G

- The Kemper experience shows that credit ratings can be restored even after a significant cost disallowance.
- The Kemper settlement was the basis for a credit rating upgrade on March 14, 2018. S&P stated:

> "We are upgrading MPC [Mississippi Power] because it has resolved the operating and regulatory missteps surrounding the Kemper project and we have restored our view of its former standing within the Southern group given the parental support exhibited through most of the episode. We are raising its SACP [stand alone credit profile] to 'bbb' from 'bb+', as it has emerged from the Kemper failure with a stronger balance sheet from Southern equity infusions and more projected deleveraging…"[57]

[57] S&P Global Ratings, "Southern Co. and Most Subsidiaries Ratings Affirmed, Outlooks Remain Negative; Mississippi Power Upgraded to 'A,'" Mar. 14, 2018.

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Rate Cut Analysis

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RATE CUT ANALYSIS

Impact Analysis - CFO Pre-W/C to Debt

- The ratio of Cash Flow from Operations (before changes in working capital) to Debt measures the ability of a company to pay off its debt.
- Cash Flow from Operations "encompasses all earning related activities of the enterprise." It does not include long-term capital or investment costs.[58]
- The next slide reproduces the Moody's chart depicting SCANA's CFO Pre-W/C to Debt previously shown on Slide 22. The new slide shows the impact on the ratio for 2017 if revenue is reduced by $445 million (equivalent to an 18% rate cut).
- A revenue reduction of $445 million reduces CFO by $278 million after accounting for 2017 taxes.[59]
- The adjusted ratio falls by 3.9 percentage points to 14.1% which is within both the historical range and a range consistent with a Moody's Baa rating.[60] The impact on this metric after an 18% rate cut would not indicate a significant reduction in SCANA's ability to service its debt.

[58] This assumes a 37.5% marginal tax rate as used by SCANA's witness Ms. Lapson.
[59] Leopold A. Bernstein, *Financial Statement Analysis: Theory, Application, and Interpretation*, 4th ed. (Homewood, IL: Irwin,1989).
[60] Moody's, "Credit Opinion," Mar. 9, 2018, 7.

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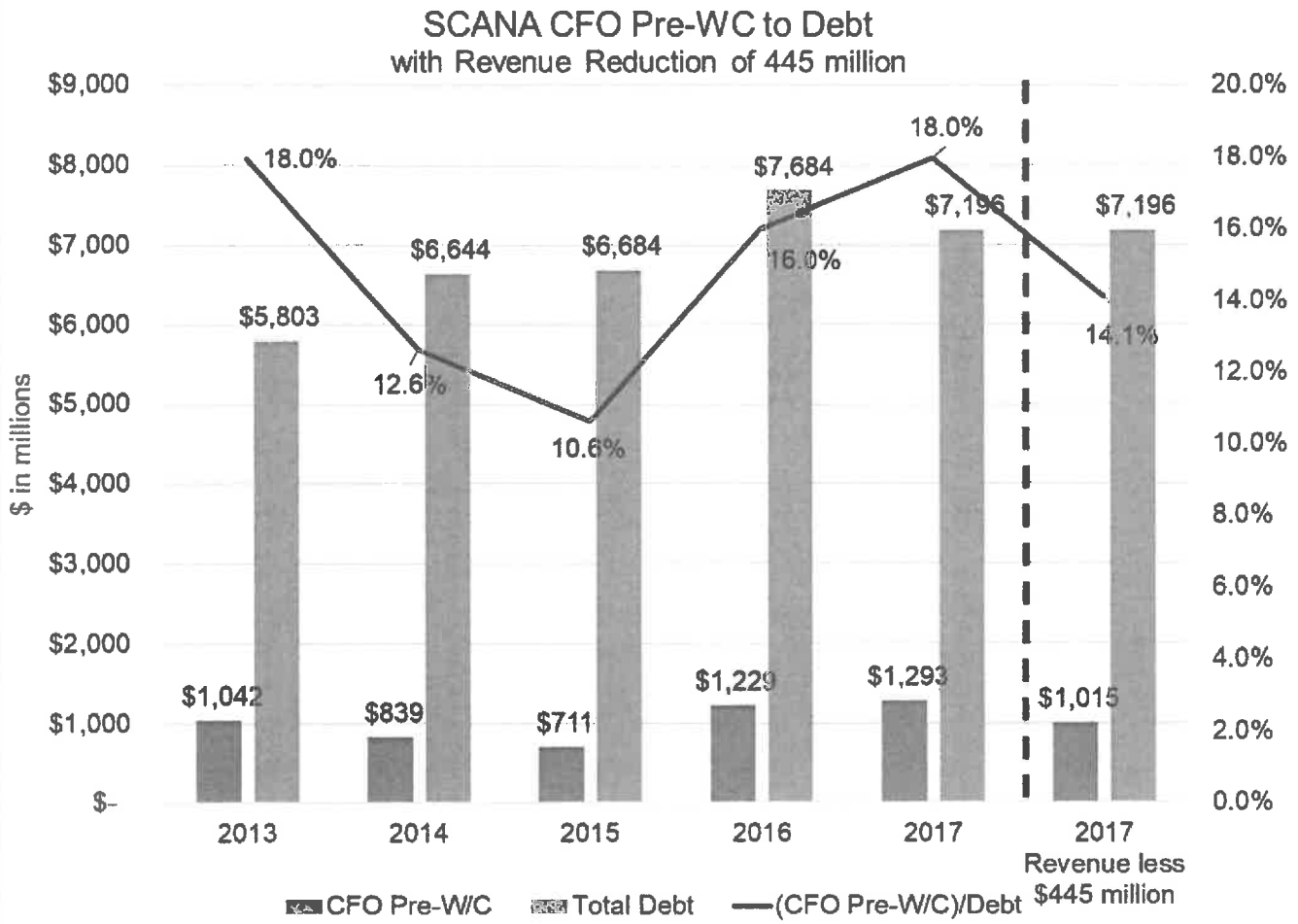
RATING AGENCY ANALYSES

SCANA CFO Pre-WC to Debt



Data Source: Moody's, "Credit Opinion", Mar. 9, 2018, 2.

2017 Revenue reduced by $445 million. A marginal tax rate of 37.5% was assumed, reducing CFO Pre-W/C by $278 million

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RATE CUT ANALYSIS

Impact Analysis - Debt to Capitalization

- The rating agencies and SCANA witnesses have pointed out that the Debt to Capitalization ratio cannot exceed 70% without potentially jeopardizing access to credit under certain credit agreements.[61]
- An interim reduction in revenues will effect the Debt to Capitalization ratio differently from a permanent reduction.
- A permanent reduction in revenues can, under many conditions, trigger an impairment or write-off that will directly increase the Debt to Capitalization ratio.
- The response to an interim rate reduction is more nuanced. It would involve future expectations and an evaluation of discounted cash flows – and may or may not result in an impairment. With no impairment, there is little effect on the Debt to Capitalization ratio.
- In the event that an interim rate reduction of 18% equal to a $445 million revenue reduction required an impairment of equal magnitude, capitalization (through equity) would be reduced by $278 million after taxes. This reduction in equity would increase the debt to capitalization ratio by only 1.4%, from 53.0% to 54.4%.[62]

[61] Moody's, "Credit Opinion," Mar. 9, 2018, 6.
[62] This calculation uses a "financial" definition of debt that includes total debt.

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RATE CUT ANALYSIS

Impact Analysis – SCE&G Debt to Capitalization

- The next slide shows the debt to capitalization ratio for SCE&G before and after a $445 million impairment. The slide also shows the debt to capitalization ratios for all S&P-rated electric utility companies in the BBB rating category. The boxes in the chart contain the middle 50% (25% - 75%) of the company ratios. SCE&G is positioned at the 75% level with approximately 25% of the companies having a higher ratio.
- After the $445 million impairment the debt to capitalization ratio for SCE&G increases from 53.0 to 54.4.
- In the event of an 18% permanent rate reduction resulting in a $3.8 billion impairment,[63] the debt to capitalization ratio would increase to 62% if measured using long-term debt only,[64] or to 67% if measured using total debt.[65] These levels are still below the threshold of 70% that could put SCANA's ability to access credit agreements at risk.

[63] The amounts currently in customer rates, $37 million per month or $445 million per year, are associated with $3.8 billion in Summer costs.
[64] Lapson, Exhibit EL-6. This is the measure of capital for regulatory reporting as used by Ms. Lapson.
[65] Lapson, Exhibit EL-6. This is the financial method as used by Ms. Lapson.

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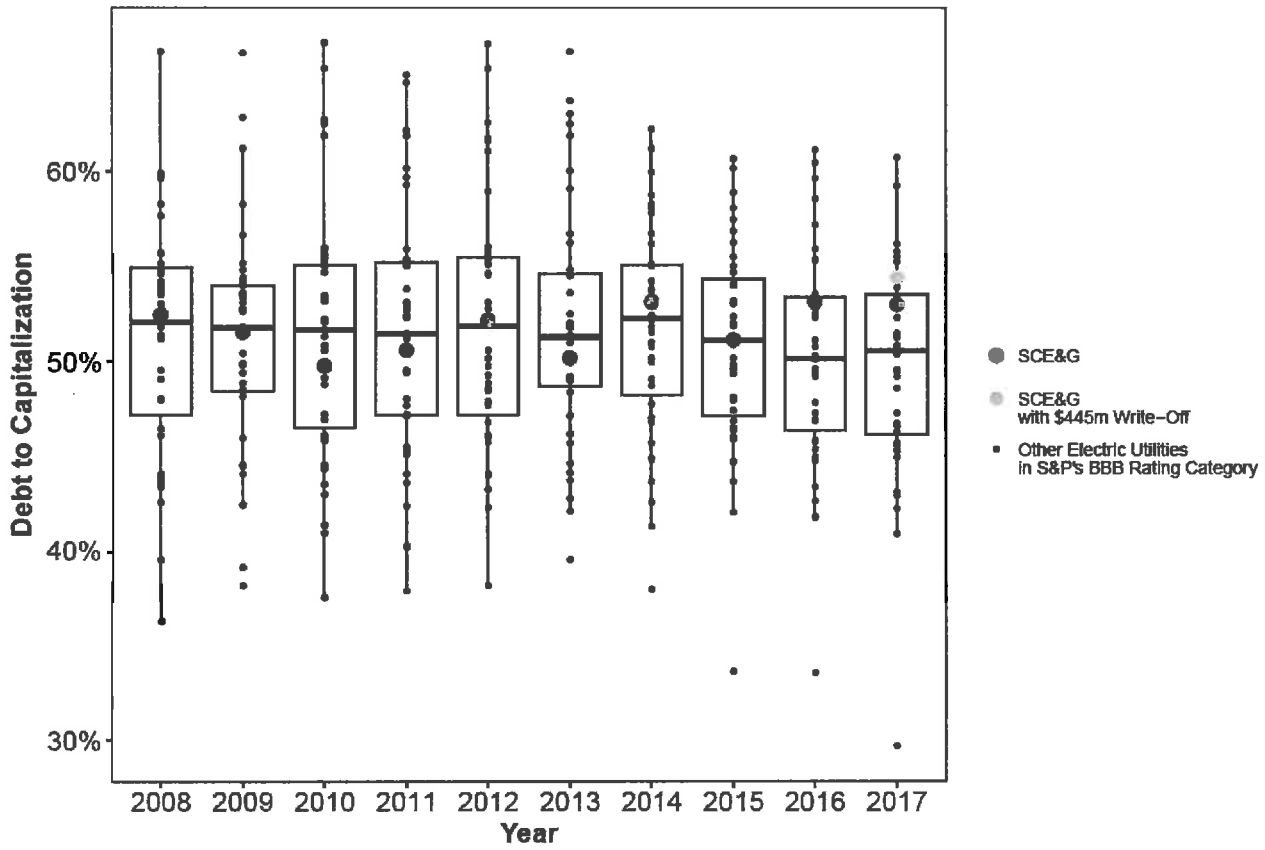
RATE CUT ANALYSIS

SCE&G Debt to Capitalization with $445 million Write-off



Data Source: S&P Capital IQ.

2017 Revenue adjusted by $(445) million. Capitalization adjusted by $(278) million after applying a 37.5% marginal tax rate.

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RATE CUT ANALYSIS

Fitch – SCANA Debt to EBITDAR

- We examined the impact on the Debt/EBITDAR ratio of a reduction in revenues of $445 million – an amount equivalent to an 18% rate cut.
- The revenue reduction, when applied to 2017 amounts, increases the ratio from 4.5x to 6.1x. The effect is shown on the next slide.
- A ratio of 6.1x is at a level which if maintained consistently, Fitch identifies as potentially meriting a decrease in SCANA's credit rating.[66]

[66] Fitch, "Fitch Downgrades SCANA to 'BB+' / SCE&G to 'BBB–'; Negative Watch Maintained," Sept. 29, 2017, 3.

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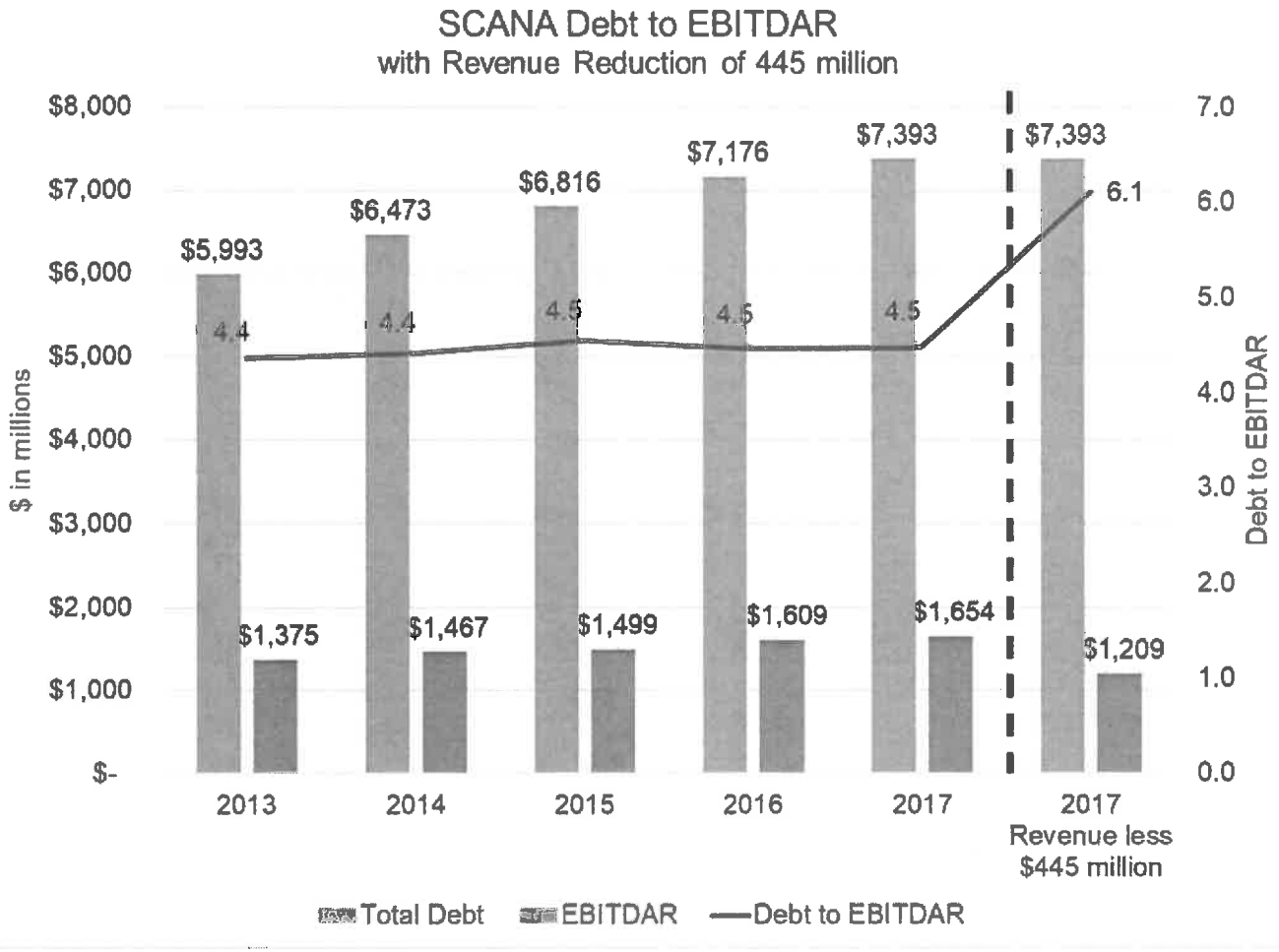
RATE CUT ANALYSIS

SCANA Debt to EBITDAR



Data Source: S&P Capital IQ.
2017 Revenue and EBITDA adjusted by $445 million.

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RATE CUT ANALYSIS

Fitch - EBITDAR

- Based on Fitch's criteria, the Debt/EBITDAR ratio may result in a rate cut if it consistently and materially exceeded 5.5x.[67]
- Other electric holding companies have experienced short-term increases in this ratio above 5.5x that have not negatively impacted the company's credit rating.
- The slide on the next page shows temporary increases in the Debt/EBITDAR ratio for two electric holding companies: FirstEnergy Corp. and PNM Resources, Inc. FirstEnergy experienced a dramatic increase in this ratio in 2014 with no credit rating impact. PNM experienced a similarly sized increase in 2015, and its credit rating actually increased a notch.

[67] Fitch, "Fitch Downgrades SCANA to 'BB+' / SCE&G to 'BBB–'; Negative Watch Maintained," Sept. 29, 2017, 3.

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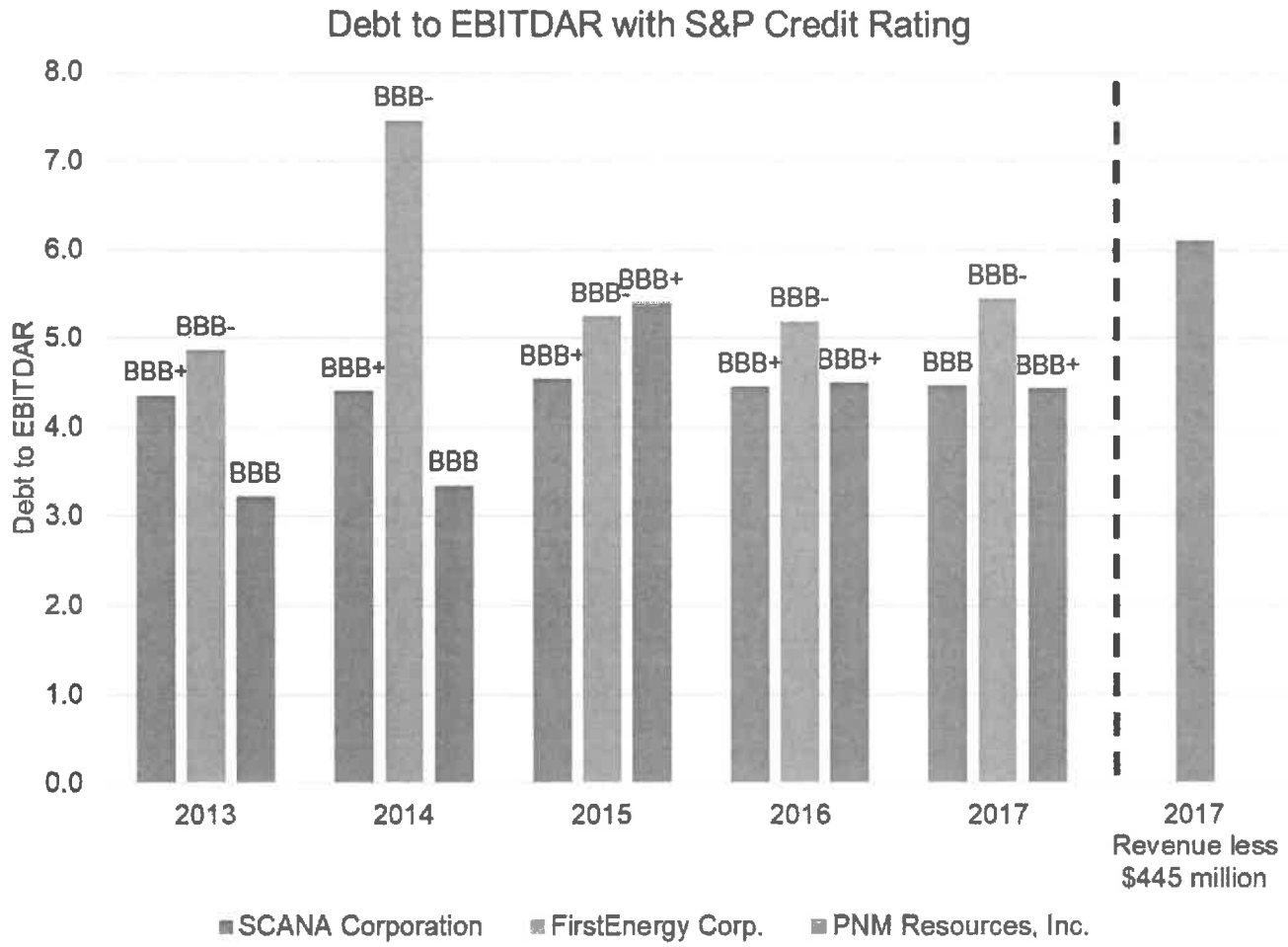
RATE CUT ANALYSIS

SCANA Debt to EBITDAR



Data Source: S&P Capital IQ
2017 Revenue and EBITDAR adjusted by $445 million.

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RATE CUT ANALYSIS

SCANA Dividends

- One of the options available to SCE&G and/or SCANA to compensate for the revenues lost to an interim rate cut is to reduce dividends.
- In a February/March 2017 Investor Presentation,[68] SCANA included information on its dividends, reproduced on the next slide.
- SCANA has had consistent growth in its dividends through 2017, it has maintained an adjusted Payout Ratio (dividends as a percentage of earnings) above 57%.

[68] SCANA, "Safe Harbor Statement/Regulation G Information" (investor presentation, Feb/March 2017), https://www.scana.com/docs/librariesprovider15/pdfs/presentations-and-transcripts/2017-ubs---morgan-stanley-utilities-conferences.pdf?sfvrsn=2?.

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RATE CUT ANALYSIS

Spring 2017 SCANA Investor Presentation

Dividend Growth

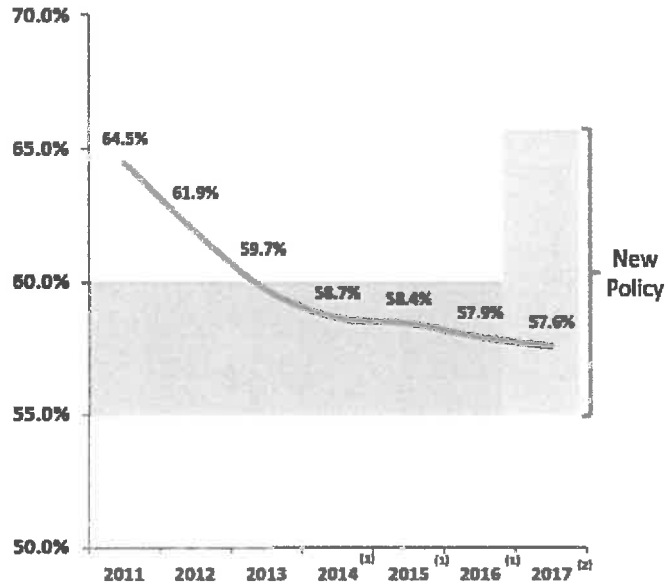
DIVIDEND POLICY: To increase the annual cash dividend at a rate that reflects the earnings growth in the Company's businesses, while maintaining a payout ratio of 55-65%

- Paid dividend for 260 consecutive quarters
- Increased dividend in 62 out of the last 66 years

Common Dividends

* 2016 indicated rate

GAAP-Adjusted Payout Ratio



(1) GAAP-Adjusted Weather Normalized Dividend Payout Ratio
(2) Calculated using the 2017 indicated rate and 2017 EPS target of $4.25. New payout ratio policy 55-65%.

"We are within our stated payout policy of 55%-65% and expect to grow dividends fairly consistently with earnings growth prospectively."

February/March 2017 15

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RATE CUT ANALYSIS

Utility Industry Dividend Comparison

- We compared the dividends paid by SCANA to those paid by its peers – utility holding companies with credit ratings in the BBB rating category.
- We used the measure of dividends as a percentage of revenues.[69]
- As shown on the next slide, SCANA's dividend to revenue ratio has been greater than 50% of its peers over the last nine years.
- Each of the dots on the chart represents the dividend to revenue ratio of an individual company. 50% of the dividend to revenue ratios are within the box. The line through the center of the box is the median.
- In the last three years, SCANA's dividend to revenue ratio has increased. In these years, SCANA's dividend to revenue ratio is greater than approximately 75% of the utilities in its peer group.

[69] Revenues were used instead of the standard earnings because of write-offs that resulted in negative earnings.

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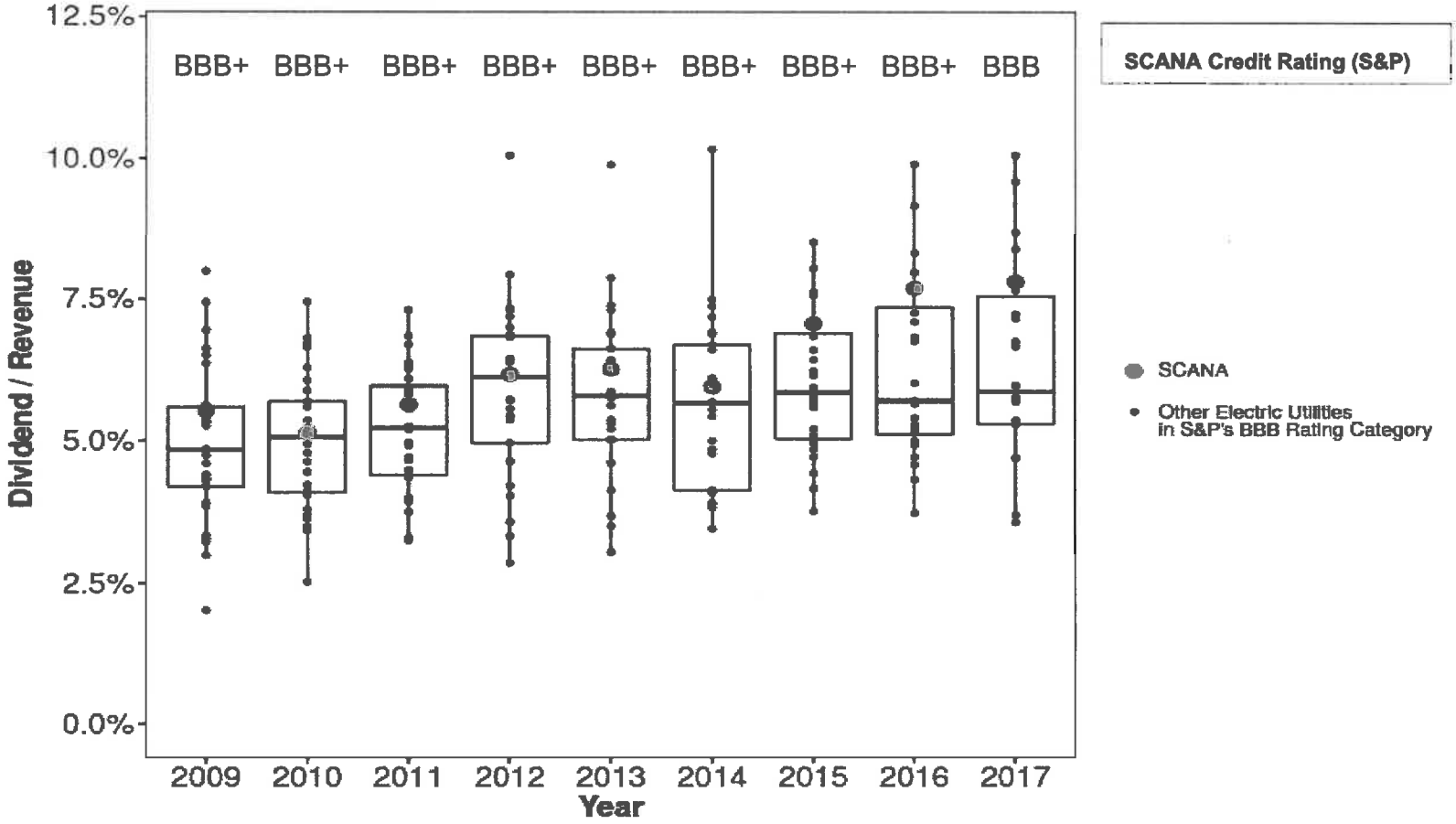
RATE CUT ANALYSIS

Utility Dividend Payment as a Percentage of Total Revenue



Data Source: S&P Capital IQ

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Regulatory Settlement Analysis

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REGULATORY SETTLEMENT ANALYSIS

SCANA 9.75% Scenario

- As part of a settlement initiative, SCANA directed Morgan Stanley and RBC Capital Markets to prepare financial forecasts under various scenarios.
- Two scenarios (and a third scenario ultimately proposed by SCANA[70]) are summarized in the SCANA/Dominion merger filing at the SEC.[71]
- One scenario included a 9.75% reduction in rates to electric customers. This scenario was characterized as one "under which SCE&G would provide the largest reduction in electricity rates it could on a stand-alone basis while still maintaining an investment-grade credit rating for SCANA."[72]
- The 9.75% settlement scenario was a package. In addition to a permanent 9.75% rate cut reducing revenues by $233 million, it included over $1.8 billion in write-offs, recovery of $1.9 billion in nuclear construction cost amortization through existing revenues over 50 years, a small reduction in dividends, and commitments on new generation.

[70] SCANA presented a 3.5% reduction in rates publicly.
[71] Dominion, SEC Form S-4, Feb. 14, 2018, 78–83.
[72] The rating would be maintained on a stand-alone basis, i.e., excluding effects of the Dominion merger.

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REGULATORY SETTLEMENT ANALYSIS

Rate Cut Comparison

- The 9.75% rate reduction in SCANA's settlement scenario is not directly comparable to the interim rate analysis, primarily because SCANA is considering a permanent reduction.
- Both the interim and permanent term rate reductions can incorporate reductions in dividends and/or capital expenditures, and increases in debt.
- The key difference between an interim rate reduction and the 9.75% scenario is the addition to the latter of a write-off and debt restructuring. This requires the two approaches to be evaluated separately.

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Conclusions

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CONCLUSIONS

Questions 1 and 2

- Our conclusions summarize our response to the three questions posed to us by the South Carolina Senate.

  1. **What actions are available to SCANA and/or SCE&G in response to an interim rate reduction?**

- SCANA and SCE&G can take three actions, singularly or in combination, in response to an interim rate reduction of up to $445 million per year or about 18% of total revenue: (a) reduce dividends; (b) reduce capital expenditures; and/or (c) increase short-term borrowing.

  2. **What interim reduction in rates can be absorbed by SCANA and/or SCE&G without significantly increasing the likelihood of insolvency?**

- We conclude that one way that SCE&G could absorb an interim rate reduction of at least 13% is by reducing dividends by $319 million[73] – the actual amount of dividends paid by SCE&G to SCANA in 2017.

[73] The $319 million is an annualized value. The length of the interim rate would dictate the actual total reduction.

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CONCLUSIONS

Dividends

- Dividend reductions are the expected response by any corporation to financial difficulties since equity investors take on that risk in exchange for the opportunity to earn a higher return.
- Dividend reductions will do two things that protect debt investors: (a) increase cash available to pay debt service and other expenses; and (b) increase retained earnings which lowers the share of total capital provided by debt. This is one of the reasons we conclude that the dividend cut can be absorbed without substantially increasing the likelihood of insolvency.
- SCANA has also paid out more of its revenue as dividends than 75% of the utilities in its peer group.
- We have identified one viable way that SCE&G can absorb a 13% rate cut, but there may be other better options. SCE&G is in the best position to determine how to absorb this cut. We are not ruling out the possibility that a higher rate cut is absorbable, but such a determination would require information not available for this analysis.

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CONCLUSIONS

Question 3

3. What are the estimated impacts on SCE&G financial metrics associated with various levels of rate reduction?

- The credit rating agencies have focused on three metrics in their analyses of the financial difficulties of SCANA and SCE&G.
- One measure, in essence, compares the amount of cash available to pay debt service to the level of debt held by a utility.[74] Even with the full 18% revenue reduction, this ratio is estimated at 14.1% which is within the acceptable range for Moody's. This one metric indicates that the full 18% revenue reduction could likely be imposed without diminishing the credit standing of SCANA/SCE&G.

[74] This is the ratio of CFO pre-W/C to Debt.

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CONCLUSIONS

Question 3 Continued

- A second metric measures the percentage of total capitalization attributed to debt. SCANA/SCE&G are subject to a financial covenant on some of their debt limiting the debt to capitalization ratio to 70%. An interim rate reduction that is by definition temporary until the PSC finishes its investigations, may reduce the extent or likelihood of impairment. A permanent 18% revenue reduction would increase this ratio to 62% or 67% which is still below the 70% level defined in SCE&G's credit agreements. And a permanent 13% revenue reduction would increase this ratio to only 57% or 62%.
- A third metric measures the level of debt to earnings.[75] Fitch has indicated that this should be below 5.5x. With the full 18% rate reduction the ratio would increase to 6.1x – notably above Fitch's threshold of 5.5x and, therefore, potentially resulting in a rating decrease. A13% rate reduction, however, increases this ratio to only 5.5x.

[75] This is the ratio of Debt to EBITDAR (earnings before interest, tax, depreciation, amortization, and rents).

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- This report presents Bates White, LLC's ("Bates White") analysis with regard to the impact of an interim rate decrease, and is provided to you for informational purposes only. In the preparation of this Report and the opinions that follow, we have made certain assumptions with respect to conditions which may exist or events which may occur in the future. While we believe these assumptions to be reasonable for the purpose of this Report, they are dependent upon future events, and actual conditions may differ, perhaps materially, from those assumed in this report. We have used and relied upon certain information provided to us by sources which we believe to be reliable, but we have not independently verified the accuracy of that information, and therefore cannot guarantee its accuracy or reliability. While we believe the use of such information and assumptions to be reasonable for the purposes of our Report, we offer no other assurances thereto and some assumptions may vary significantly due to unanticipated events and circumstances. To the extent that actual future conditions differ from those assumed herein or provided to us by others, the actual results will vary from those projected herein. Finally, this Report summarizes our work up to the date of the Report. Thus, conditions occurring or becoming known after such date may affect the material presented to the extent of such changes, perhaps materially.

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