September 1, 2016

VIA ELECTRONIC FILING
Jocelyn Boyd, Esquire
Chief Clerk and Administrator
South Carolina Public Service Commission
101 Executive Center Drive
Columbia, SC 29210

RE: Petition of South Carolina Electric & Gas Company for Updates and Revisions to Schedules Related to the Construction of a Nuclear Base Load Generation Facility at Jenkinsville, South Carolina
Docket No. 2016-223-E

Dear Ms. Boyd:

Enclosed please find the Direct Testimony of Kevin W. O’Donnell filed on behalf of South Carolina Energy Users Committee in the above referenced docket. By copy of this letter, I am serving all parties of record.

If you have any questions or if I may provide you with any additional information, please do not hesitate to contact me.

Sincerely,

SCOTT ELLIOTT

Enclosures
CC: All parties of record (w/encl.)
BEFORE
SOUTH CAROLINA PUBLIC SERVICE COMMISSION
DOCKET NO. 2016-223-E

In the Matter of:

Application of South Carolina Electric and Gas Company for Updates and Revisions to Schedules Related to the Construction of a Nuclear Base Load Generation Facility at Jenkinsville, South Carolina  Docket No. 2016-223-E

Direct Testimony

of

Kevin W. O'Donnell, CFA

On Behalf of

South Carolina Energy Users Committee

September 1, 2016
BEFORE
SOUTH CAROLINA PUBLIC SERVICE COMMISSION

DIRECT TESTIMONY OF KEVIN W. O'DONNELL, CFA

Q. PLEASE STATE YOUR NAME, POSITION, AND BUSINESS ADDRESS FOR THE RECORD.

Q. ON WHOSE BEHALF ARE YOU PRESENTING TESTIMONY IN THIS PROCEEDING?
A. I am testifying on behalf of the South Carolina Energy Users Committee (SCEUC), which is an industrial trade association in South Carolina. Many of SCEUC's members take retail electric service from South Carolina Electric & Gas Company (SCE&G or the Company) and will be impacted by the proceedings in this case.

Q. PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND RELEVANT EMPLOYMENT EXPERIENCE.
A. I have a Bachelor of Science in Civil Engineering from North Carolina State University and a Master of Business Administration from the Florida State University. I earned the designation of Chartered Financial Analyst (CFA) in 1988. I have worked in utility regulation since September 1984, when I joined the Public Staff of the North Carolina Utilities Commission (NCUC). I left the NCUC Public Staff in 1991 and have worked continuously in utility consulting since that time, first with Booth & Associates, Inc. (until 1994), then as Director of Retail Rates for the North Carolina Electric Membership Corporation (1994-1995), and since then in my own consulting
I have been accepted as an expert witness on rate of return, cost of capital, capital structure, cost of service, and other regulatory issues in general rate cases, fuel cost proceedings, and other proceedings before the North Carolina Utilities Commission, the South Carolina Public Service Commission (Commission), the Virginia State Commerce Commission, the Minnesota Public Service Commission, the Colorado Public Service Commission, the Wisconsin Public Service Commission, and the Florida Public Service Commission. In 1996, I testified before the U.S. House of Representatives, Committee on Commerce and Subcommittee on Energy and Power, concerning competition within the electric utility industry. Additional details regarding my education and work experience is set forth in Appendix A to my direct testimony.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. The purpose in my testimony in this proceeding is to review the request of the BLRA. In this testimony, I will specifically address the return on equity (ROE) the Commission should set for the financing costs associated with the BLRA.
I. Higher Capital Cost Request

Q. UNDER WHAT STATUTE IS THE COMPANY SEEKING TO INCREASE RATES TO COMPENSATE IT FOR THE CONSTRUCTION OF THE SUMMER NUCLEAR PLANT?
A. S.C. Code Ann. 58-33-210 et seq., otherwise known as the Base Load Review Act (BLRA), allows SCE&G to seek authority from the Commission to revise its rates during the construction of a nuclear plant to pay for capital costs associated with the plant construction. Since its Base Load Review Order, SCE&G has implemented eight rate increases associated with the BLRA and a ninth request was recently filed at the Commission in Docket No. 2016-224-E. The rate increases sought by SCE&G for this 2016 BLRA increase are as follows: 3.10% for the residential class; 2.99% for the small general service class; 3.25% for the medium general service class; and 2.96% for the large general service class.

Q. PLEASE EXPLAIN THE COMPANY’S REQUEST IN THIS CASE.
A. SCE&G is asking this Commission to approve an updated construction schedule and capital cost schedule for the Summer Nuclear Plants. The proposed capital cost schedule includes a request for the Company for approximately $852 million in additional costs from last years Base Load Review Act (BLRA) proceeding.

II. Return on Equity

Q. HOW HAS THE BLRA AFFECTED THE FINANCIAL RESULTS OF SCANA CORP.?
A. The BLRA has been instrumental in helping the Company achieve strong earnings. Below is an excerpt from the July 28, 2016 earnings call of SCE&G:

Testimony of Kevin O’Donnell, CFA (SCEUC)
**Jimmy Addison** - Chief Financial Officer

The increase in earnings is due to higher electric margins, principally as a result of the continued recovery of financing costs through the BLRA and customer growth, partially offset by milder weather during the second quarter of 2016 versus the same period of 2015 and lower average use. The impact of the previously mentioned depreciation study also contributed to earnings for the quarter. (underline added)

However, SCE&G residential, commercial, industrial, government ratepayers are bearing the cost of SCE&G’s strong earnings. Since 2009, SCE&G has been granted eight rate increases under the BLRA for a cumulative total rate increase to consumers of 18%. A chart of these rate increases can be seen below.

**Chart 1: Annual BLRA Rate Increases**

![Annual Rate Increases under BLRA](chart.png)

Testimony of Kevin O'Donnell, CFA (SCEUC)
When one looks at the above rate increases, the annual rate hikes appear somewhat manageable at roughly 2.5%. However, it is important to understand that these rate increases are cumulative. Chart 2 shows the cumulative rate impact on SCE&G customers due strictly to the BLRA increases.

**Chart 2: Cumulative BLRA Rate Increases**

If the Commission approves the rate increase sought by the Company in Docket no. 2016-224-E, rates will have increased over 20% from 2009 through November, 2016. Furthermore, the above-stated increases do not reflect annual fuel changes or two base rate increases the Company has been granted since 2009. Simply put, the number of rate increases experienced by SCE&G customers is overwhelming, particularly in a period when incomes have been relatively flat.
Q. HOW IS THE RATE OF RETURN SET FOR SCE&G'S FINANCING COSTS ASSOCIATED WITH ITS INVESTMENT IN THE SUMMER NUCLEAR PLANT?
A. Under the BLRA, the ROE allowed by the Commission is the Company’s most recent rate case preceding the base last review order.

Q. WHAT IS THE BLRA ROE THE COMPANY IS CURRENTLY EARNING AND WHEN WAS IT SET?
A. At present, SCE&G is earning an 10.5% ROE on financing costs associated with the BLRA and was set in Docket No. 2015-103-E.

Q. WHAT IS THE ROE SCE&G IS EARNING ON ALL OTHER CAPITAL?
A. SCE&G filed rate cases in 2009 (Docket No. 2009-489-E) and in 2012 (Docket No. 2012-218-E), the latter reducing the Company’s ROE from 10.7% to 10.25%. Unfortunately for consumers, the BLRA ROE was not reduced in any of those three cases to account for the lower financing costs now inherent in the US economy.

Q. HAS SCE&G ACKNOWLEDGED THE LOWER FINANCING COSTS IN TODAY'S MARKETPLACE?
A. Yes. In his testimony in the 2015 BLRA rate proceeding, which was Docket No. 2015-103-E, SCE&G CEO Kevin Marsh specifically cites lower interest rates as one component that is used to offset higher capital costs associated with the Summer nuclear plant. To be specific, Mr. Marsh states in his testimony:

Testimony of Kevin O'Donnell, CFA (SCEUC)
Compared to the projections presented in 2008, customers are anticipated to save approximately $1.2 billion in interest costs (in future dollars) over the life of the debt that has been issued to date to finance the project and on future issuances where interest rates have been hedged. (p. 11, l. 4-8)

The costs as cited by Mr. Marsh above pertain only to interest costs and not equity costs.

Q. HOW DOES THE BLRA AFFECT THE RISK LEVEL OF SCE&G AS PERCEIVED BY THE INVESTMENT COMMUNITY?
A. With the current filing, SCE&G has now filed nine rate increases from the BLRA. The Company has been granted rate increase in each of the previous eight requests. The BLRA effectively shifts a significant part of the financial burden associated with new nuclear plants away from the utility and to captive ratepayers. As such, the risk level of SCE&G as perceived in the marketplace is significantly lowered through the BLRA.

Q. WHAT HAVE STATE REGULATORY COMMISSIONS ACROSS THE COUNTRY APPROVED FOR ALLOWED ROES SINCE 2008?
A. Below is a graph that shows the average allowed ROE for electric utilities from state commissions across the United States from 2008 through 2015.

Chart 3: Average Allowed ROE from 2008 through 2015
As can be seen in this chart, the average allowed ROE by state commissions across the United States has been trending downward since 2009. The South Carolina Public Service Commission, itself, recognized the lower cost of equity when it reduced SCE&G’s ROE from 10.7% to 10.25% in the Company’s 2012 general rate case.

Q. WHAT HAS BEEN THE AUTHORIZED ROE ACROSS THE COUNTRY IN 2016?

A. To-date in 2016, the average allowed ROE, excluding limited issue rider cases, in 2016 is 9.60% as shown in Table 1 below.
Table 1: 2016 Authorized ROEs

<table>
<thead>
<tr>
<th>State</th>
<th>Company</th>
<th>Date</th>
<th>Return on Equity (%)</th>
<th>Common Equity /Total Cap (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>New York</td>
<td>NY State Electric &amp; Gas Corp.</td>
<td>6/15/2016</td>
<td>9.00</td>
<td>48.00</td>
</tr>
<tr>
<td>New York</td>
<td>Rochester Gas &amp; Electric Corp.</td>
<td>6/15/2016</td>
<td>9.00</td>
<td>48.00</td>
</tr>
<tr>
<td>New Mexico</td>
<td>El Paso Electric Co.</td>
<td>6/8/2016</td>
<td>9.48</td>
<td>49.29</td>
</tr>
<tr>
<td>Arizona</td>
<td>UNS Electric Inc.</td>
<td>8/18/2016</td>
<td>9.50</td>
<td>52.83</td>
</tr>
<tr>
<td>Washington</td>
<td>Avista Corp.</td>
<td>1/6/2016</td>
<td>9.50</td>
<td>48.50</td>
</tr>
<tr>
<td>Arkansas</td>
<td>Entergy Arkansas Inc.</td>
<td>2/23/2016</td>
<td>9.75</td>
<td>28.46</td>
</tr>
<tr>
<td>Maryland</td>
<td>Baltimore Gas and Electric Co.</td>
<td>6/3/2016</td>
<td>9.75</td>
<td>51.90</td>
</tr>
<tr>
<td>New Jersey</td>
<td>Atlantic City Electric Co.</td>
<td>8/24/2016</td>
<td>9.75</td>
<td>49.48</td>
</tr>
<tr>
<td>Massachusetts</td>
<td>Fitchburg Gas &amp; Electric Light</td>
<td>4/29/2016</td>
<td>9.80</td>
<td>52.17</td>
</tr>
<tr>
<td>Indiana</td>
<td>Indianapolis Power &amp; Light Co.</td>
<td>3/16/2016</td>
<td>9.85</td>
<td>37.33</td>
</tr>
<tr>
<td>Tennessee</td>
<td>Kingsport Power Company</td>
<td>8/9/2016</td>
<td>9.85</td>
<td>40.25</td>
</tr>
<tr>
<td>Indiana</td>
<td>Northern IN Public Svc Co.</td>
<td>7/18/2016</td>
<td>9.98</td>
<td>47.42</td>
</tr>
<tr>
<td></td>
<td>Average</td>
<td></td>
<td>9.60</td>
<td>46.14</td>
</tr>
</tbody>
</table>

Source: SNL Financial

As can be seen in the table above, no state has authorized a ROE in excess of 10.0% in 2016.

Q. HOW DO YOU RECOMMEND THE COMMISSION RECOGNIZE THE LOWER MARKET REQUIRED RATE OF RETURN IN THE CURRENT BLRA PROCEEDING?

A. South Carolina consumers should not be forced to pay higher rates to compensate SCE&G for a ROE that is grossly out of touch with current market requirements. As can be seen in Chart 3 and Table 1 above, state regulators across the United States have recognized the lower cost of
equity and adjusted allowed ROEs accordingly. This Commission should do the same in this case. Based simply on a comparison of allowed returns from other states, I recommend that, in authorizing an updated capital cost schedule, the Commission set the BLRA ROE equal to 9.85%, which was the average ROE allowed by state regulators across the United States in 2015.

Q. DOES THIS COMPLETE YOUR TESTIMONY?
A. Yes, it does.
CERTIFICATE OF SERVICE

The undersigned employee of Elliott & Elliott, P.A. does hereby certify that (s)he has served below listed parties with a copy of the pleading(s) indicated below by mailing a copy of same to them in the United States mail, by regular mail, with sufficient postage affixed thereto and return address clearly marked on the date indicated below:

RE: Petition of South Carolina Electric & Gas Company for Updates and Revisions to Schedules Related to the Construction of a Nuclear Base Load Generation Facility at Jenkinsville, South Carolina

Docket No.: 2016-223-E

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PLEADING: DIRECT TESTIMONY OF KEVIN W. O’DONNELL ON BEHALF OF SOUTH CAROLINA ENERGY USERS COMMITTEE

September 1, 2016

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