STATE OF SOUTH CAROLINA)
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COUNTY OF UNION)

VERIFICATION

PERSONALLY appeared before me, Bryan D. Stone, who being duly sworn states: That he is the Chief Operating Officer and Assistant Treasurer of Lockhart Power Company; that the testimony attached hereto as Testimony of Bryan D. Stone, is based upon information that he believes to be true and correct.

Bryan D. Stone

Bryan D. Stone

Sworn to before me this 7
day of February, 2011

Rabecka Chavis

Rabecka Chavis

My Commission Expires: January 14, 2019

Q. Please state your name, business address, present position and responsibilities.

A. My name is Bryan D. Stone. My business address is Lockhart Power Company, Post Office Box 10, 420 River Street, Lockhart, South Carolina 29364. I am Chief Operating Officer and Assistant Treasurer of Lockhart Power Company. In this role I have responsibility for the company's overall performance and management.

Q. Please summarize your educational background and professional experience.

A. I have earned both the Bachelor of Science in Electrical Engineering Degree and the Master of Science in Electrical Engineering Degree from the Georgia Institute of Technology, as well as the Master of Business Administration Degree from the University of Florida. I am a registered Professional Engineer in the state of Florida.

I began my professional career in 1990 as a Project Engineer at a 500^{+} employee chemical fertilizer company near Tampa, Florida. My responsibilities involved implementing nearly all electrical and instrumentation ("E&I") projects, including those associated with the approximately 40 MW cogeneration plant used to convert waste process heat to electricity. In 1996 I accepted a similar position at a larger company in rural northern Florida. While my responsibilities were similar in nature, the scope was much larger, since the new employer had $1{,}200^{+}$ employees in two chemical complexes (each with its own cogeneration plant) and a mining operation, all within the same county. In 2000, I was promoted to E&I Maintenance Superintendent, with responsibilities for the E&I Maintenance Department, including more than 70 E&I technicians and salaried employees. I had the additional responsibilities of Power Manager, which ultimately included managing over $50 million in combined power purchases and sales. In this

capacity, I worked with representatives of various classes of customers, utilities, and legislators on a variety of power-related issues.

I joined Lockhart Power Company ("Lockhart" or "the Company") in April 2006. I testified before this South Carolina Public Service Commission ("Commission") in Lockhart's last rate case, Docket Number 2007-33-E.

Q. What is the purpose of your testimony?

A. My testimony will provide a brief overview of Lockhart. With this overview as a backdrop, I will describe the primary reasons why Lockhart is pursuing a rate adjustment, and the reasoning behind several key aspects of the proceeding including the rate of return per customer class and the cost of equity.

Q. Please provide an overview of Lockhart Power Company.

A. Lockhart Power Company was incorporated in 1912 by an act of the South Carolina legislature. Its service area spans parts of five counties: Union, Spartanburg, Cherokee, Chester and York. It serves approximately 6,300 customers, through the effort of 42 employees. In addition, the Company serves one wholesale customer, the City of Union.

The first General Manager for Lockhart was hired in 1920, and he is one of only three Company leaders who have preceded me in the years since. My immediate predecessor was in his position for nearly 30 years, providing a very stable long-term direction for the company. His tenure was marked by a focus on tight cost control, continually improving efficiency, and increasing the capacity and reliability of the company's 100% renewable energy generation portfolio. He also implemented a strategic focus on the core electric utility business, including overseeing the divestiture of

telephone, trash, water and wastewater businesses.

Today, Lockhart has 18 MW of hydroelectric generation capacity on the Broad River in Lockhart, South Carolina, which is also the location of its business offices. The hydroelectric generation typically satisfies 20-25% of the company's load. The Company also owns a 0.8 MW hydroelectric facility in Pacolet, South Carolina, and a 5.5 MW diesel peaking generation station in Pacolet, South Carolina. The remainder of the power needed to serve the Company's customers is purchased from Duke Energy ("Duke").

Lockhart purchases power from Duke at a wholesale rate which is based on Duke's cost of service and which has been approved by the Federal Energy Regulatory Commission (FERC). Changes in the monthly purchased power expense above or below an authorized rate base amount due to load, internal generation, etc. are passed on to Lockhart's customers via a flow-through purchased power adjustment clause. Purchased power expense is a significant percentage of Lockhart's operating costs.

Q. Please describe proposed changes to the Schedule "O" Purchased Power Adjustment Clause.

A. The current Schedule "O" provides the mechanism by which Lockhart flows purchased power costs through to its customers, at cost. This helps ensure Lockhart's customers pay a true cost-of-service based rate. Recent additions to Lockhart's generation portfolio have necessitated several modifications to the Schedule "O". First, now that Lockhart has existing and proposed generation assets with associated fuel costs, namely the Pacolet diesel generation station and the pending Union diesel generation station (described

below), Lockhart proposes that actual fuel and associated costs (fuel transportation, sales tax, etc.) flow through the clause to Lockhart's customers, at cost. Second, Lockhart proposes that Schedule "O" be modified to allow certain new rate base generation assets to sell power off-system, with the resulting revenues flowing through the clause as a credit to benefit Lockhart's customers. This will be beneficial to Lockhart's customers because with the Wellford Landfill Gas project (discussed below) and other similar generation projects, the maximum value for the generation in the short-term will be obtained by selling the power off-system. The revised Schedule "O" will be renamed the "Power Adjustment Clause" to reflect the broader nature of its purpose.

Q. Please provide an overview of recent changes to the Duke Energy power purchase agreement.

A. Lockhart purchases a majority of its power generation needs (75-80%) from Duke. The previous contract under which Lockhart purchased power from Duke expired at the end of 2008. The new contract was negotiated during an extended period and includes several substantive changes. First, the rate Lockhart pays Duke is calculated each year formulaically, based on Duke's actual incurred costs, helping ensure Lockhart's customers pay a true cost-of-service based rate. Second, the demand charge is now calculated based on Lockhart's power usage during the one hour period each year in which Duke reaches its system peak load (i.e. the 1 Coincident Peak or 1 CP method). This is a departure from the 12 CP method historically used, with rate-making implications described in more detail by witness Parmelee. Third, a mutually agreeable maximum peak-shaving capacity for Lockhart was identified that provides significant value for Lockhart's existing

generation resources, and provides the opportunity for Lockhart to add another valuable peak-shaving resource by purchasing an existing diesel peaking station from the City of Union, SC.

Q. Please describe the actual economic impact of the Pacolet diesel and Pacolet hydroelectric generation resource additions described in the 2007 rate case.

A. The economic benefit received by the Company's customers from the installation of the 5.5 MW Pacolet diesel peaking generation station in late 2006 has been significantly greater than expected, due in part to changes in the contract under which the Company buys power from Duke. In particular, the change from a 12 CP to a 1 CP method places more economic emphasis on the demand value of the power Lockhart purchases, and less on the energy value. This and other changes have resulted in an increase in the overall economic value of the peaking generation of more than 30% in the last three years. According to Duke's recent forecasts, there may be a similar increase over the next three years. While the initial net economic benefit for Lockhart's customers was estimated to be approximately $75,000-$80,000 per year, the actual benefit for the 2009 test year was closer to three times that amount. After this rate case, the benefit will increase further, based on lower than expected operating and maintenance expenses in the test year, and a further depreciated basis in the facility.

The Pacolet hydroelectric plant has also provided greater economic benefit to Lockhart's customers than projected, for the same reason. The value of the generation was over 25% greater than expected, and operating and maintenance costs were less than expected. In addition, the Pacolet hydroelectric purchase included an option to purchase

an undeveloped "Upper" dam approximately one half mile upstream of the plant for a nominal cost. After further investigating the economic case for developing the Upper dam, Lockhart has determined that there will be economic benefit for its customers in doing so, particularly if the project qualifies for federal American Reinvestment and Recovery Act (ARRA) stimulus funds as is anticipated.

Both of these recently added generation sources have demonstrated their usefulness in helping manage power purchase expenses. In addition, the generation has demonstrated its usefulness in acting as a hedge against future purchased power price increases. The experience gained in developing these generation resources and subsequently operating and maintaining them has laid the groundwork for the Company to pursue additional generation plant resources.

Q. What are the key drivers behind the need for a base rate adjustment?

A. The primary driver is recent significant capital investment in new generation, which will provide both immediate and long-term net economic benefits to our customers. The largest single investment is approximately $2.5MM for the construction of a new landfill gas to power project located in Wellford, SC. While the project assets will be placed in rate base, the power generated will not initially be used to directly serve Lockhart's customers. In order to maximize the economic benefit to Lockhart's customers, the power will instead be sold initially off-system to a company that can utilize the full value of the generation, including the renewable energy attributes. The off-system revenues will flow back to Lockhart's customers through the revised Schedule O "Power Adjustment Clause" as described above. This will provide a significant premium to the value Lockhart's

customers would currently receive if they directly used the generation. The power sales agreement has a ten-year term, at the end of which the then-current energy market conditions will be used as the basis for whether to use the power to self-serve Lockhart's customers, or to continue selling the power off-system.

The second largest recent investment driving the need for a base rate adjustment is approximately $1.5MM to purchase a generation station with four 1,825 kW diesel peaking generators from the City of Union. Although the cost recovery for this project will result in increased base rates, this increase will be more than offset, beginning immediately, by a decrease in the customers' purchased power adjustment clause costs. A base rate increase is therefore needed, even though the project provides immediate net economic benefits to the customers. It is noteworthy that the $1.5MM purchase price is less than the $1.8MM cost of building the Pacolet diesel generation station in 2006 using similar generators, even though the Union station has 1/3 more capacity than the Pacolet diesel station.

Q. Please describe the Wellford Landfill Gas to Power project.

A. The Wellford landfill is owned and operated by Spartanburg County ("County"), which has entered into a public-private collaboration to convert the landfill methane gas ("LFG") created by the landfill waste into useful energy in an environmentally friendly manner that destroys this potent greenhouse gas. The County will sell and transport a portion of the LFG by pipeline to a nearby private manufacturer to use as a substitute to using natural gas for process heat. The remaining LFG will be purchased by Lockhart and used to fuel a 1.6

MW LFG-fueled electric generator, similar in design to Lockhart's existing diesel peaking generators.

Lockhart has entered into a long-term agreement to purchase the LFG at a reasonable cost with modest escalation, protecting its customers from fuel price risk. The County will own the gas collection system and the gas treatment system upstream of the Lockhart's generator, significantly reducing Lockhart's capital investment when compared to other projects of this type. Lockhart expects to obtain ARRA stimulus funds to offset part of the project capital cost, further reducing the cost basis for Lockhart's customers. Lockhart will have one person operate and maintain its equipment, as well as the County's equipment (under contract), so as to reduce operating costs and risk for its customers and to ensure the entire LFG system is operated and maintained to maximize the amount of LFG available to generate power.

The LFG project will provide a net economic benefit to customers over time as both the price and quantity of the generation increase..There are several factors that contribute to this trend. First, the unit price of the power will contractually increase at a fixed escalation rate. Second, the quantity of power generation will increase as the landfill expands, until the generator is producing at its rated capacity. Third, as the plant equipment depreciates, the rate of return portion of the revenue requirement will decrease. Furthermore, there is upside potential should the private manufacturer pipeline customer use less LFG than its stipulated cap.

Lockhart's parent company has agreed to forego more than an entire year's dividend in order to fund this project for the benefit of its customers.

Q. Please describe the Union Diesel Generation Station Purchase.

A. The 7.3 MW diesel peaking generation station ("Station") was built in 2005 and includes four (4) generators and associated controls housed inside a dedicated building, four (4) step-up transformers, one switching station, two (2) 15,000 gallon fuel storage tanks, and related equipment all situated on 0.68 acres adjacent to an existing Lockhart substation. The Station has been directly connected to Lockhart's system since its construction, so Lockhart is very familiar with its generation profile and operating characteristics. The generating units are nearly identical to those Lockhart purchased and installed in late 2006. These factors combine to predict a low operating risk profile for the Station, coupled with no construction risk since it is an existing Station. Furthermore, due to the long-term positive working relationship between Lockhart and the City of Union (Lockhart's wholesale customer), counterparty risk is believed to be minimal.

As with Lockhart's existing diesel generation resources, the new Station will provide increasingly significant customer value over time. There will be immediate net economic benefits to customers, as demonstrated via pro forma calculations presented in testimony by Lockhart's witness Paul Inman. This immediate benefit is driven by the attractive below net book value price that was negotiated. In addition, the economic benefits should increase over time as the cost of purchased power demand costs from Duke increase, perhaps dramatically. Therefore, the purchase of this Station will act as an important cost savings measure immediately, and serve as a noteworthy hedge against future wholesale rate increases.

Lockhart and the City of Union have entered into a binding purchase agreement dated April 29, 2009, and approval of the agreement is requested.

Lockhart's parent company has agreed to forego nearly an entire year's dividend in order to fund this project for the benefit of its customers.

Q. How has Lockhart's customer base changed since the last rate case?

A. Lockhart's residential and commercial customers have decreased slightly since 2006. Lockhart's industrial load, however, has dropped dramatically due to the permanent shutdown of its second largest retail customers, which as recently as 2007 represented more than 10% of its total sales, and more than 18% of its retail sales. Lockhart has added one notable industrial customer, which has helped mitigate some of the economic impact of losing the larger industrial customer. Detailed analysis related to the loss of the large industrial customer is provided by witnesses Parmelee and Inman.

Q. How has Lockhart's total retail revenue requirement changed since the last rate case?

A. Expert testimony by Mr. Parmelee is included in this filing that details the approach used to determine Lockhart's retail revenue requirements. Lockhart is requesting a rate increase of 2.5% from its current rates, which were based on a 2005 test year and became effective in August 2007. Importantly, a larger increase would have been required had the Union diesel generation purchase previously described not been included in this filing, since as discussed it results in an immediate net economic benefit to the customers.

Q. How would the Residential, Commercial, Industrial, and Lighting classes of customers be affected if equal rates of return were applied to each class?

A. Residential customers would have an increase of 6.1%, Commercial customers an increase of 8.6%, Industrial customers a decrease of 8.1%, Street Lighting an increase of 8.6%, and Outdoor Lighting an increase of 9.6%.

Q. Why would there be such a discrepancy between classes if an equal rate of return approach were used?

A. Over time different revenue growth rates and cost allocations between customer classes can result in changes in the returns generated by each customer class.

Q. Is Lockhart's requested adjustment based on an equal rate of return approach?

A. No. Lockhart is using a modified equal rate of return approach, which better balances the needs of the various customer classes. The modification is that a floor was set on the amount of the adjustment to any class of 0%, i.e. no customer class was given a rate decrease. This approach benefits the Residential, Commercial and Lighting classes of customers by mitigating the increase to those classes, while still moving all classes closer to the average retail rate of return. This accomplishes the dual objectives of improving the fairness of the rate structure while minimizing the impact on any single class of customers.

Q. What are the resulting effects on each class of customers?

A. The Residential class of customers will have an increase of 3.2%, the Commercial class will have an increase of 4.5%, the Industrial class will have no adjustment, and Street and Outdoor Lighting customers will have an increase of 4.5% and 5.0%, respectively. Despite the increases to the Residential, Commercial and Lighting classes, those classes will still have rates providing a return noticeably below the retail average, while the Industrial class will remain noticeably above the system average. However, the magnitude

of the disparities between classes will be decreased compared to current rates, resulting in a more equitable rate structure.

Q. How was the cost of equity determined?

A. Expert testimony by Paul R. Moul is included in this filing that details the approach used to determine Lockhart's cost of equity. Mr. Moul also prepared cost of equity testimony for the last rate case (Docket 2007-33-E), which was approved by the Commission. The same methodology is used in this case, updated to reflect current economic conditions. I would like to highlight the portion of his testimony that discusses the size premium appropriate for Lockhart. Lockhart's size is literally several orders of magnitude below that of its peer utilities, resulting in a dramatically higher level of risk, and a correspondingly higher cost of equity. This higher level of risk is demonstrated by the concentration of sales represented by a few large customers, and the earnings impact that losing one of these large customers recently had on the Company. Were Lockhart to request the premium adjustment for which it is qualified as a micro-cap sized company, its resulting cost of equity would be 13.64%. In order to control costs for its customers, Lockhart has requested a lower adjustment, corresponding to that appropriate for a much larger company. The result is Mr. Moul's calculated 12% cost of equity.

Q. What adjustment was made to the cost of equity as determined by the cost of equity consultant?

A. Lockhart has made a modest adjustment based on factors that are outside the scope of Mr. Moul's analysis. This is a one half of one percent increase to recognize the recent significant and tangible economic benefits afforded Lockhart's customers by virtue of

Lockhart's unusually customer-centric performance. This performance is exemplified by the two generation addition projects described previously, and the manner in which they were implemented. Both projects were implemented using unusually innovative and aggressive cost control measures, to enable our customers to receive immediate or near-term net economic benefits from each. The long-term cumulative reduction in customers' rates as compared to not pursuing the additions is dramatic. Lockhart's parent company agreed to reinvest approximately two years' worth of dividends to allow this to happen. These and other specific examples of Lockhart and its shareholders voluntarily going "above and beyond" to achieve significant cost savings for the benefit of its customers demonstrate that Lockhart should receive a modest adjustment to its cost of equity. The resulting cost of equity used for this filing is 12.5%.

This adjustment is performance-based, using actual, recent and significant cost-savings to customers resulting from the Company's efforts. It is also an incentive for the Company to continue to behave in this manner, to the net benefit of its customers. This is important because Lockhart's five year capital outlook includes approximately 50% growth in its net plant due to discretionary, cost effective renewable energy generation projects. The performance adjustment provides an incentive for the Company to strongly consider implementing these discretionary projects and placing them into its regulated rate base, for the economic benefit of its customers.

Q. Do you have any requests concerning the timing of this case?

A. Yes. Lockhart has recently made an investment representing approximately 10% of its total company rate base on a single project (i.e. the Wellford LFG plant) to benefit its

customers, despite the fact that the Company is not receiving a return on that investment. Furthermore, as stated in witness Parmelee's testimony, the Company earned well below its authorized rate of return during the 2009 test year. In order to mitigate the ongoing negative economic impacts associated with these factors, Lockhart respectively requests an expedited review and ruling on this proceeding. Furthermore, the purchase of the City of Union's diesel generator station has a contractual deadline of May 31, 2011.

Q. Please summarize your testimony.

A. Lockhart has recently made significant capital investments specifically to provide immediate net economic benefits to its customers. Lockhart requests that the Commission approve the rate adjustment and associated Schedule "O" tariff revisions as described in Lockhart's rate application. Furthermore, Lockhart requests that the Wellford LFG to power facility be placed in rate base, and that associated revenues flow through to Lockhart's customers dollar-for-dollar via the newly revised Schedule "O". Lockhart also requests that the Commission approve the diesel generation station purchase from the City of Union and the associated proposed rate treatment.

Q. Does this conclude your prepared direct testimony?

A. Yes.